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**MONEY  
IN  
INDUSTRY.**



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# M O N E Y    I N I N D U S T R Y

By

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## INTRODUCTION.

To write an account of the whole working of money in industry will seem to many a large undertaking. This is because anything to do with money is supposed to be difficult, but the principle difficulty is to unlearn the numerous misconceptions which have been put about on the subject. On this account I hope that an occasional elementary simplicity will be excused.

As to the size of the subject it has been reduced as far as possible by the rigid exclusion of technical processes, many of which would be outside my ability to discuss. As an example I have noticed that the word "bill" or, in its orthodox sense, "discount," does not appear anywhere in the book. Yet the discounting of bills is probably the principle activity of the money market. My object has been to show effects more than processes both in criticising the present system and in proposing remedies.

As it is clearly impossible to say everything at once there has been a certain difficulty in arranging the information in the right order so as to assume nothing that has not been previously explained. It is partly as a compromise in this direction that I have had to include one or two chapters explaining, not how industry works, but how it does not. For the same reason I must ask indulgence of an occasional anticipation and numerous repetitions.

As to explaining how money does not work in industry, it is essential to counter the propaganda which is freely put about to say that it works according to "inexorable economic laws" whereas in fact it has to be very carefully managed, and, unfortunately, it is not now being managed in the interests of the population, but in the interests of an obsolete system.

The discovery of this aspect of the matter is fairly recent, although a comprehensive literature on the subject already exists. I would like to excuse an addition to this on the grounds that while the fundamental unsoundness of the system is ably explained, the reasons for its continued existence have not been made so clear. A casual observer picking up a book which shows that the present system cannot possibly work is apt to realise sooner or later that the same system has been in operation for centuries; and, even if the working has been fitful, it has managed to grind along somehow and even show increased standards of living.

I trust I have managed to reconcile these two points of view and at the same time have shown how the disadvantages of the system have become acute in recent years. I have also pointed out the difficulties of curing the present depression by nineteenth century methods and trust that the outline of a more reasonable plan will receive consideration.

I have confined myself to the point of view of Britain and the £ sterling. Not in an unduly patriotic sense, but to conform with the language in which I am writing. The situations will be virtually

the same with other countries and other currencies.

I offer due appreciation to the numerous authors whose works have been consulted for the purpose of this investigation, especially the works of Major C. H. Douglas, "The Story of Money" by Sir Norman Angel, and "The History of the Pound Sterling" by A. E. Feavearyear.



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## CHAPTER I.

### *The meaning and purpose of Industry.*

Before entering into a discussion as to how the efficiency of industry might be increased, it is essential to have some agreement, not only as to what object industry is striving to obtain, but also as to what we mean by industry.

Taking a preliminary definition one might say that industry was the activity undertaken by man in the production of material things; in which would be included the products of agriculture and fisheries, and any of the hunting and trapping industries that may remain. There are, however, many human activities outside this definition. The work of a clergyman for example would never be considered as industrial although his stipend is possibly paid by the agricultural industry and he himself may be financially interested in industry as a shareholder in some company.

If we now add to our definition the production of services as well as of goods we add many activities which were previously excluded. The clergyman's obituary notice often includes the statement that his whole life was given to the service of others. A lawyer gives services. Advertising is a service. Literature, Insurance, keeping a pub and keeping a bank, are all services. In fact a large part of all

human activities can be included in the production of goods and services.

But why only a part? Surely almost all human activities can be included in this definition?

That is a point of view usually taken up by text books both political and economic, and it is only comparatively recently that the other, and larger part of human activities has begun to receive serious attention. If man spends part of his time in the production of goods and services he must spend the remaining part in their consumption, otherwise he will fill the world with unused products.

The reason that this most important part of man's activities has been previously ignored is that it is only comparatively recently that man became able to produce so abundantly and quickly that by far the larger part of his time might now be occupied in consumption. Prior to the industrial revolution it was not particularly easy for man to go on existing at all. If he could produce enough to maintain life he did so, otherwise he starved and in neither case did the problem of consumption occupy much of his thinking.

Now, however, consumption has become a most important part of industry, and the difficulty of arranging adequate consumption is our principle difficulty to-day. It is therefore impossible to leave this aspect of the problem outside any discussion of industry and we must extend our definition to include consumption as well as production.

With the definition of industry thus extended to cover the whole of production and the consumption

of both goods and services, we find the definition very nearly extended to cover the phenomena known as life. Yet it is difficult to see how this extension can be in any way reduced. Consumption is now the most important side of industry if only because no business could exist for long without customers who are going to consume the goods. Services also must have consumers of some sort to absorb them, and they too, must of course be included in the widest possible definition of industry: not only personal services like those of the accountant and the advertising agent, but material services like those performed by the ship and the locomotive which produce nothing of themselves. Consequently those who produce ships and locomotives are only rendering services and it would be clearly absurd to exclude shipping and railways from a definition of industry.

Having extended industry to cover most of the material side of life, the question "What is industry for?" seems likely to include the spiritual, for to ask the object of life is undoubtedly a religious or philosophic question. We will however try to keep the material side before us, and begin by considering what is the object of production.

Most people will see, as soon as it is pointed out to them, that the real object of industry is consumption. Man spends a large part of his time in producing a complex variety of goods and services, only that he may derive use and pleasure from subsequently destroying them again. Even the most permanent of buildings, such as a stone factory for the manufacture of boots, will eventually become

worn out through the process of making millions of pairs, which will themselves be destroyed upon the feet of the people.

This object of production being virtually destruction may seem to some people a "waste" and offend their thrifty instincts. Nevertheless the process is inevitable, and as long as use and pleasure are derived from the continued and simultaneous production and consumption of goods and services, there is no reason for restricting the process, or for regret. Indeed it would be absurd when we have produced such a thing as a motor car if we were not to drive it for fear of the wear and tear involved and still more ridiculous to abstain from making, say, a gramophone record, because the record might get worn out by playing.

The object of industry is, then, consumption, and as we have said most people will see this when it is pointed out to them. Yet in the course of conversation numerous other ideas are wittingly or unwittingly put forward as being the object of industry.

The giving of employment is at present the most popular of these, and the efficiency of any proposal for reform is actually measured by whether it will employ more or less people. I have, I believe, also heard it implied that it is essential that industry should be so organised as to ensure the people being kept out of mischief, or at any rate to be compelled by the financial system, to perform a tale of work each day.

If this giving of employment is to be the main or even a subordinate object of industry, an entirely

different policy must be pursued to that which must be followed if the object of industry is to be consumption, as measured by a higher standard of living for all classes. Labour saving devices must be sternly repressed, and a policy must be followed similar to that of the Luddites, who wished to destroy all machinery. Even the suggestion of digging holes and filling them up again is not as ridiculous, under this policy, as would appear to people of normal sanity.

Another idea which often creeps into economic discussions is that the object of industry is production for its own sake. This suggestion is due to a flaw in the financial system, which it is hoped will be clearly shown in the latter parts of this book. The relevant facts in the meantime are that during any period of production there is not distributed, as incomes, enough purchasing power to pay the price that must be charged for the goods finished in that time. The only way that these things can be sold is with purchasing power distributed in the making of products which will not be on the market till next week or next year. The effect of this is that the goods, at present in the shops, can only be sold if we embark on an extensive programme of production for the future, and that is why the sayings of noted economists, when translated into simple English, are found to mean that the way to cure overproduction is to produce more.

The difficulty of the idea of production for its own sake is to find an outlet for the product, for the whole world is becoming industrialised and wishes to

export its goods. This results in a struggle for markets which has been the cause of several wars in the last hundred years, and, unless the financial problem is solved in the near future, is likely to lead to further conflicts.

Nevertheless, many people appear to think that the export trade is an end in itself and that the object of British industry should be to make thousands of tons of valuable things and send them abroad, while erecting complicated tariff barriers to prevent anything being sent back in return. This idea which might have been possible for one country during the nineteenth century obviously cannot be so for all countries, and a financial system which insists on a surplus of exports is bound to lead rapidly to disaster.

Allied to this idea of exports for their own sake, as opposed to the fair exchange of goods more conveniently produced abroad, is the question of foreign investments. Some people, usually those who receive a commission upon them, believe that these investments are the object of British industry. During the nineteenth century the shortage of purchasing power, to which we have alluded, was made up by means of development loans to backward countries, and by means of these loans the products which our own people could not buy were exported abroad. It will, I hope, be shown that these goods were virtually given away, in the shape of government, municipal and development loans which are never repaid, except by the issue of another loan or by converting directly into a new one.

Nevertheless, interest on the loans is expected

annually, and this can only be paid by the import into Britain of the goods of the country concerned. Needless to say these cannot arrive in the face of prohibitive tariffs, and when the interest on old loans is likely to exceed the issue of new ones, the system of export, for its own sake, must break down.

Such a state of affairs has now arisen, and we are forced back to the idea that the main object of British industry must now be to increase the standard of living of our own people. There is, however, room for controversy as to how far it may be desirable to allow this standard of living to rise, as the standard rendered possible by the efficiency of modern industry is so large as to be almost outside the comprehension of the majority of social reformers.

A mass of statistics to prove this would, I think, be out of place, but it is worth while to glance at a few of the great discoveries which should have made the lot of modern man an easy one, though for some reason they have failed to do so.

First in time and probably in importance, is James Watt, who rendered the steam engine practicable. The world's productive power was probably increased at least tenfold on the day that the first beam began to oscillate. Faraday discovered the principles which made possible the dynamo and electric motor. Machines to render service, perhaps, more than production. Yet none the less a valuable real credit to the community. Otto invented his four stroke cycle and man became able to take to the roads and to the air. Mendel made his experiments with plant breeding, through which the wheat latitudes have



now been pushed to within five hundred miles of both poles and equator. Dunlop, with his pneumatic tyre, and a hundred others whose names have been forgotten.

The Great War, whatever the hardships involved, at least showed what could be done in the way of production, and that with most of the best labour in the country employed elsewhere. Since the war the advance has been even greater. Ford and Courtauld to quote two more names. And, of course, Marconi, who is responsible for the creation of a larger new luxury industry which has come into existence in the last ten years.

Without a mass of statistics, then, it should be clear that man has solved the production problem. If anyone should still be in doubt, let him try and think of any want, reasonable or unreasonable, that modern manufacturers are not prepared to supply for money down.

So enormous are the powers of production now available that the standard of living of everybody could probably be increased many times over. Are we sure that such an increase is desirable, and that it is proper to produce as much as the people desire to consume, as opposed to what someone set in authority considers it desirable that the people should have?

These production statements are not proved here as this is purely a financial discussion, but they can be checked from any industrial statistics. The reason that the standard of living suggested is not attained already is merely that the machines necessary to produce such a standard are not manufactured, as

the makers are sure that the people would not have sufficient money to buy their products.

All this has kept the average standard of living to a mere fraction of that which is mechanically possible. In some cases the standard is so low as to constitute starvation. And very real want can be seen in any of our large towns and in most country villages.

Is it desirable to try and alter this state of affairs?

It would be difficult to find anyone who would say no to this question as whenever two or three are gathered together one hears of the necessity of curing unemployment and restoring prosperity.

Yet many people hesitate at carrying things to their logical conclusion and trying to organise consumption so that the people shall have everything that it is mechanically possible to give them. It is almost usual to hear a tone of regret when anyone speaks of the good clothes, charabanc drives, motor bikes, etc., which are occasionally enjoyed by some of the poorer classes, and it is suggested that there is something wrong in so much time and money being spent in cinemas, dance halls and football fields.

Coming from the more well to do people there may be a certain amount of justification in the idea that these things are provided at their expense. Taxation is high to provide social services and dividends are lower, through the efforts of the trades unions to provide a decent standard for their members. The possibility of its being unfair for one man to have more than another does not, in my view, give the majority the right to divide up the wealth of

the minority. At any rate one can understand the minority concerned being apt to regret a financial system which is founded upon such a division. Yet to those who have studied the production problem, even superficially, it appears quite unnecessary that the rich need suffer because the standard of living of the poor is increased. There could, if production was allowed to flow freely, be plenty for all.

I do not think, however, that the tone of regret at increased standards of living is confined to the more well to do people. Naturally, no one will complain at his own standard of living being raised, but he is often a little restive at undue expansion on the part of neighbours. The implication in such remarks as "Chits o' girls, what can't do a room!" and "In at five o'clock and off to the pictures indeed!" is heard just as often from those with shillings a week incomes as from those with hundreds a year.

I believe that the reason for this is psychological and that we have to borrow from psychology in inventing the phrase "Scarcity complex" to describe this attitude and the tone of regret which is often adopted towards increased wealth on the part of other people.

This tone of regret may be due to the same inbred instinct. For the whole of man's existence there has been a real struggle against scarcity under primitive conditions which made it difficult to wring a livelihood from nature. All wealth had to be hoarded and eked out for, should there be a good harvest or a good kill, man found that it was against his best interests to consume that year or that day the

whole of his product. Perhaps the next year or the next day the product would fail.

There is the well known example of Joseph in Egypt, who caused the corn to be saved during the seven fat years so that there would be something to consume during the seven lean years, and there are those who attribute the present monetary system to the lesson learnt at that time, and during the subsequent time of scarcity in the wilderness.

Not that it is necessary to go to Biblical times to find examples of a community, or sections of a community, consuming too fast. I am told that, in the year 946, half the population of France died of starvation, and thousands of deaths from famine still occur in China. There are doubtless also farmers and munition workers who wish that they had saved more during the good times of the first world war, though the latter example is entirely a monetary phenomenon. The standard of living, which both the farmer and the munition worker requires, is waiting somewhere in the world for each of them. In the meanwhile, the latter may be starving for want of farm produce while the farmer is suffering from the lack of skilled mechanical engineers.

In addition to any inbred influence we are also all trained to the idea of Scarcity. Exactly like our ancestors, most of us have spent our lives struggling with a greater or less degree of poverty, and one soon gets the idea into the mind that it is positively wrong to indulge in more than a certain minimum standard of living. From this follows an unconscious resentment of any indulgence on the part of neighbours,

and there is a tendency to suffer pain instead of pleasure from their enjoyment. This attitude is what I should like to call the Scarcity Complex. It may have been valuable to man in the days of scarcity, but it is out of place in an age where science has provided abundance. The analogy frequently employed being that of ship-wrecked mariners fighting for and eking out the supply of water in their boat, while ignorant of the fact that it has drifted into fresh water, and they have only to dip their supplies from overside.

Those who hesitate at making the full benefits of production available for the people who have in various ways built up the product, are advised carefully to examine their minds for the scarcity complex before condemning reforms on the grounds that they allow too high a standard of living.

There are two other complexes closely allied to that of scarcity which may also be briefly examined. They are the "jealousy complex" and the "revenge complex". The jealousy complex is expressed in the idea that because I have a £1 per week standard of living it is therefore wrong for others to have a £10,000 per annum standard. This also is undoubtedly founded upon the instinct that there is not enough to go round, but it has the justification that whereas nature, together with man's ingenuity, has made ample provision for everyone, the supply of £s, which are man-made tokens, is in truth grossly inadequate.

But in the meanwhile I wish to leave out the restrictions of money and to point out that it is undoubtedly wrong that the average man cannot get access to goods which he has possibly helped to make

and which are waiting for him. Yet it is in no way a consequence that it is wrong for those who do have access to the goods to indulge their privilege. There is plenty for all, and by living up to his income a rich man will tend to distribute his money or title to goods to the less fortunate, and will make such distribution far more efficiently than if the money is collected and redistributed through the agency of Whitehall.

The "Revenge Complex" is usually found among the Communist party, and even many Socialists, who may be mild and charming men to meet, are very reluctant to support any scheme for helping the poor which does not at the same time injure the rich. Without dragging religion into a book on finance it is impossible here to overlook the Christian teaching. It is unnecessary to argue with a revenge complex. It is just wicked.

The rich, of course, may have their characteristic faults, but I do not think that it has ever been shown that these are greater than those of the poor. Indeed, I should have said, that considering the greater opportunities for evil enjoyed by rich people, these were on the whole more social than the less fortunate. But a discussion on these lines would only lead us into digression. Our intention here being to try and consider social reforms on their merits, and not to become involved in the exposure of petty spites between one class of society and another.

We are agreed then that, when we mention industry, we mean the production and the consumption of all goods and services, and that the object of industry is to organise the production so that it shall

be sufficient to supply the wants of the people. It being noted in passing that the wants of the people are something quite different from their present monetary demands.

We have stated that the producing side of industry, while at present kept back by various restrictions, is nevertheless potentially fairly efficient, and, were the opportunities for consumption to increase, the removal of restrictions would enable producers to keep up with demand without great alteration of organisation.

It appears, then, that what is wrong with industry is on the consuming side. Man, at present, is tending to consume less than he produces, not because he does not want to consume more, but because he cannot obtain access to the things which he has made, or to the product of what he has made when the latter is in the form of productive machinery.

## CHAPTER II.

### *The meaning and purpose of Money.*

In the previous Chapter on production and consumption we have seen that the people, as a whole, are unable to obtain for consumption more than a fraction of what industry is capable of producing, and of producing without any drastic change in the plant and organisation that already exists.

This failure to obtain that which industry is anxious to produce is not confined to those who are generally classed as the poor, and who cannot perhaps secure enough of the necessities of life. Outside a very small minority, everyone, even when their incomes are of the thousands a year order, are always trying to afford something which is just out of reach. The accent being on the "just," as the goods required may actually be standing on the other side of the glass in a shop window.

Without stressing the point unduly it is clearly wrong that the people cannot obtain access to that which already exists and is for sale as everyone will in various ways have contributed to the making of these things and should in similar, or other ways, be able to divide them among themselves. There is of course no question implied here of the division being in equal shares, or of dispossessing the rich of their property. The actual owners of the goods we are



discussing are in many cases desperate to be rid of them.

Now, the reason why the needy cannot obtain goods from those anxious to sell is simple. So simple that I am afraid that you may feel cheated in some way when I tell you that it is merely because they have not enough money.

If this conclusion is disappointing I think that there is no doubt that it follows inevitably from the facts of the present situation. The goods are there, together with almost infinite capabilities of further production, and so are the people who want them. Moreover these people have collectively made the goods, but instead of just dividing them up, as might a primitive community without a money mechanism, our people must stand and regard through the glass the wealth which they have made, being unable to divide this up as they have not the money to pay the prices which must be charged.

There seems then to be some flaw in our mechanism of distributing incomes and of accounting prices, so that the total of prices is greater than the total of incomes. Whether the flaw has always existed or is a temporary condition brought about in recent years will be fully investigated in due course, but as to this being the position at present I think there can be little doubt. It seems from observation that the people as a whole have not sufficient money to buy what they have produced, and it is my object here to try and show from both theoretical and practical considerations why this deficiency of purchasing power exists.

The mention of money has hitherto been avoided as far as possible, as it was desired to show the relations between the real things of life, and to keep money in the background as being merely a means of distribution which is, or should be, under man's control. Yet it will not need pointing out that an industry as complicated and diverse as ours will need to have some medium of distribution whereby the goods and services provided by one man or firm can be exchanged for those of another.

Exchange by barter served man in primitive times, and as the money system is breaking down it is returning to fashion, being usually conducted on an international scale, e.g., Brazil has recently exchanged coffee directly with the United States for wheat. Nevertheless barter must be a very clumsy means of general trading under modern conditions.

We are forced, then, to a consideration of what is known as money, and having got thus far it would probably now be possible to write a million words on the whole nature and purpose of money without undue repetition, but in case you contemplate throwing down this book I will hasten to assure you that it is not my intention to do so. My object is rather to show that the chief purpose of money is as a mechanism for the distribution of the important and real things of material wealth.

For a definition of money it is also possible to think of half a dozen and write a book on each of them, but once people have made up their subconscious minds as to what they mean by money it is almost impossible to get them to see that it is really

something quite different. Indeed on turning to the *Encyclopædia Britannica* for an authoritative definition this is what is found. "The difficult question of the best definition of money has been complicated by the efforts of writers, so to define the term as to give support to their particular theories. . . . It is therefore best to avoid a formal definition. . . ." This, while not being very helpful, has at least the advantage of warning the author and readers against too precise a definition.

Most readers, I suppose, when they say money, mean to imply a little silver and perhaps a note or two in their pockets, with perhaps also a small balance at the bank. Indeed the term used by accountants of "cash in hand and at bankers" seems quite good enough a definition for the purpose of this volume.

It is, however, of the utmost importance to avoid confusion between money, as defined above, and real wealth in the form of things useful in themselves like food and clothes. Money nowadays being composed principally of entries in ledgers is hardly ever of any use in itself, but, as a rule, it can readily be converted into things which are of use. This convertability is the real value of money and the mysterious "something" which some people seem to believe must be "somewhere behind the money." It must be realised that the value of money does not lie in the right to exchange one's bank balance, which is an entry in a ledger, for the printed pieces of paper we call bank notes; nor does it lie in the right to buy some metal at fixed prices. The latter right does not hold in most countries, and in any case the value of metal available

never forms more than a fraction of the value of all money.

It is becoming increasingly well known that the sole value of money lies in the willingness, and of course in the ability, of the people who use that currency to surrender goods and services in exchange for the money. This, incidentally, raises a nice ethical point as to whose property should be new money when this is issued for carrying on an increasing trade. Whether the new money should be the property of those who have the right to issue it, or whether it should belong to those who are potentially able and willing to surrender their goods and services in exchange.

Let us leave ethics on one side for the moment and return to the possible confusion between money and wealth. It is not often that such real things as food and clothes will be confused with £s or dollars, but other forms of property, which frequently consist of promises to pay money under varying terms, are frequently confused with money. "I have got my money in War Loan" is a phrase frequently heard, but the speaker, of course, has not got his money. He has surrendered it in exchange for a promise from the British Government to pay him an income at regular intervals. Should he wish to obtain money again he must find someone who will give him their money in exchange for his war loan holding; and the sum offered will almost certainly be greater or less than that originally surrendered.

Those owning wealth in the form of British Government stocks have always hitherto been able to

obtain a reasonable amount of money in return for their holdings, but with many other forms of wealth the case has been very different. Numerous investors will regret the good money they surrendered in exchange for promises to share in the profits of the numerous mushroom companies floated during the 1929 boom, and not very long ago the promises of the United States of America, which many considered to be the safest in the world, were ruthlessly repudiated: dollars of less value being substituted for the commodity (gold) which was particularly specified in the original undertaking.

"Look at all the British money in India" is another slogan which ably shows the confusion between money and wealth. As British money consists of £s and the Indian currency is in rupees the amount of British money in India will, in fact, be very small indeed, being confined to the amounts which travellers forgot to get changed. Certainly much of the industry of India may be the property of British subjects, but industrial property is wealth which is entirely different from the pounds, shillings and pence which form money.

People also sometimes speak of putting their money into house property, and I know one monetary reformer who, when informed of this, patiently searches the house from cellar to attic and reappears with a most puzzled expression, saying "But where is this money? You said it was in the house." Needless to say, my friend's host has made a mistake in thinking he still has his money in his house. The money has, in fact, been taken by the seller or builder

of the house, and is by now either destroyed or circulated about the country as the property of other parties. Please do not think that these nice distinctions are over-pedantic on my part. Confusion on just such points as these is the cause of most of the misunderstanding of the money system, and, consequently, of the failure to settle most of the problems of to-day.

The confusion between money and more real things like houses or ships arises from the methods of modern accountancy, which to a greater or less extent permeate the minds of every member of the population. Under these methods almost every piece of wealth is valued in £ s. d., for some purpose or another, and it is easy to fall into the error that the article valued is in some way equal to the £ s. d. to which it is compared, and if confusion of thought is carried still further the vague idea gets about that the £ s. d. will exist somewhere to the same amount as the value of all the property in the country.

This idea is a most important and fundamental fallacy. A £, although usually only in the form of a ledger entry, is none the less a real thing in itself, and the total number of £s can be counted. They are quite separate from any wealth for which they may be exchanged, and the number of £s is, in fact, controlled by methods and considerations entirely separate from the amount of wealth. \* Nevertheless, if you examine any company's balance sheet you will see that every piece of property owned by them has been valued at some figure: even such nebulous assets as goodwill or the costs of floatation frequently

appearing. The total of all these may amount to a sum in £s containing 7, 8, or even 9 figures, but nothing could be farther from the truth than saying that £s to this amount necessarily exist. Actually the total number of £s would only form a very small percentage of the total valuation of the property in the country.

The various items on a company's balance sheet merely represent someone's vague personal opinion of what the properties might fetch if sold under certain imaginary market conditions, as any company would find who tried to sell their goodwill or costs of floatation. Even the idea of potential sale is frequently quite abandoned. Worthless assets are sometimes put in at fantastic figures for the sole purpose of balancing the accounts, and on the other hand valuable property is often "written down" to some figure like £1 with a view to the accumulation of hidden reserves. There is a story of a bank with premises all over the Continent who valued that property at one franc!

The figures which appear in these valuations are sometimes alluded to as "money of account." They may be useful for accounting purposes, but under no circumstances can they be of use in causing a transfer of goods from the producer to the consumer. For example a man may own a house valued at £1,000, yet he may starve within it if he lacks the real money necessary to buy food. Only by first selling his house can he exchange it for other things, and the fact of his being able to sell it implies that someone else had cash in hand or at bankers to surrender in exchange.

I hope it is clear that these valuations which are attempted for accountancy, insurance, and other purposes are in no way connected with real money, although the same units of measurement are used. The only item on a balance sheet which is real money is "cash in hand and at bankers." and incidentally it is not considered advantageous to have more than a small fraction of property in this form, as it is then said to be lying idle. Nevertheless it is cash in hand and at bankers, which must be in the hands of the public as being the only thing which will buy goods for consumption and perform the chief object of money in bringing the consumer in touch with the producer.

I hope it is now becoming clearer that a £ is an entity entirely distinct from other forms of wealth, just as a lemon or cheese is distinct. The total number of £s in the world can be ascertained, as can be the number of lemons, cheeses, or pairs of boots. Every individual also knows, or can find out, how many £s he possesses, just as he, or she, could take an inventory of the store cupboard. Most individuals, even when so wealthy as to be classed as millionaires, usually possess only comparatively few £s. Some well to do people never have any: they are in a perpetual state of owing £s to their bankers. This does not mean they have less than no £s. To have less than £0 is as impossible as having less than no bricks in a field. The small number of £s possessed by individuals or firms, and the increasing fashion of owing them, merely goes to show that compared to any valuation of real articles, real £s are very scarce.



It follows from this individual reality of £s that somewhere there must be a factory for the manufacture of £s like there are factories which make everything else. Just as there must be two parties to a sale, i.e., a buyer and a seller, so there must be two material parts to a sale, the goods sold and the money which buys them. Just as the goods are made up in a series of factories, so must the money be made by some similar process, and if sufficient money has not been manufactured sales will become very difficult.

It is sometimes argued by more orthodox economists that, whatever the amount of money, a sale can always be effected by the simple expedient of altering the price: they have some strange formula about supply and demand. This is all very well when the supply of money is on the large side. The seller then makes more profit. But if the supply of money is on the low side the price according to supply and demand may be below the cost of production. The producer may be forced out of business and the public be deprived of commodities which they urgently require.

Now the factory where £s are made is the Bank of England, which controls the supply through the agency of the joint stock and private banks. Under modern conditions when all £s are made of paper, and the majority are, in fact, only entries in ledgers, the difficulty incurred by the banks in making £s is very small, so small, in fact, that the manufacture of £s is frequently referred to as "creation," i.e., made out of nothing.

The number of £s made available by the banks

to carry on the trade of the country may vary a little from day to day, and will vary considerably over a period. Nor is the number of £s by any means always increasing, as the banks occasionally consider it in their interest to collect £s from the community and destroy them, with a view, presumably, of lending the remaining £s at a higher rate of interest. The system is such that in thus destroying £s the banks are not out of pocket by the number of £s destroyed, as would be a private individual who accidentally burnt Bank Notes. The action of a bank in destroying £s, by altering its ledgers, costs the bank no more than it would a private individual to destroy his cheque book. The £s destroyed by banks are, however, lost to the community, and, except in the hitherto unknown event of there having been a simultaneous destruction of other things, trade becomes very difficult to carry on in the absence of a proper supply of £s.

But we must not prolong unduly discussion which requires a chapter to itself. If it is perfectly understood that £s are entirely distinct things in themselves, just as rabbits, cheeses, or lemons are distinct, and that the available supply of £s may vary as does the available supply of fish—if this is grasped we can pass on to see how, speaking frankly, the incorrect accounting of £s, and the equivalent monetary tokens in other countries, has led civilisation to the verge of collapse.\*

\*Reading over the above it occurs to me that the facts narrated of the creation and destruction of money may appear quite incredible to those not previously acquainted with the situation. I hope it will be adequately shown in the chapter on the subject that the facts are really as outlined. Meanwhile, I would offer the excuse that on this point the public are be-

In addition to being distinct from wealth, money is divided into two kinds. Although the line of demarcation is difficult to place exactly, the money on each side of it is considered in very different ways, and consideration of this difference can, I believe, be made to show the cause of defects in our money system more effectively than other mental pictures that have sometimes been employed. I am alluding to the difference between capital and income.

Although you cannot tell by looking at a piece of money whether it is capital or income and a unit of money will change from one to the other many times in the course of a year, nevertheless the attitude of business men is very different towards the two sorts of money. Income can be spent in any way the owner pleases. On personal apparel, motor cars, mistresses, champagne, betting, or speculation, and his business friends will rather admire him. But with capital it is quite another story. "Jones is living on his capital," they say with long faces, and they look sideways at Jones for signs of the inevitable mental and physical breakdown. His solicitor will hear of it and sigh deeply, making a mental note to try and trap Jones into signing a trust deed so that the sacred capital may be kept intact.

Capital, of course, usually covers many things besides money, and much money is not usually kept in this form, for, as we saw before, it is then said to coming increasingly well informed, and that authorities, including leading bankers, are united on the matter. Though most reluctant to quote authorities in a work designed to secure personal intellectual conviction, nevertheless on this point readers may be referred to the speeches of Mr. R. Mackenna, and the *Encyclopædia Britannica*, fourteenth edition, on Banking.

be lying idle. When this happens some form of wealth is usually purchased with a view to subsequent sale at a profit. Nevertheless, in the present plight of industry, many firms are unable to "take a view" or see their way to selling anything at a profit. Consequently working capital does lie idle in the bank, and this money is pointed at to refute the charge that industrial depressions are due to lack of money. But the money at present\* in the banks is the wrong sort. It is capital money which is of no use to get the things out of the shops and into the hands of consumers.

The essential difference between capital and income money is that a purchase on capital account will never finally extinguish a cost, as the recovery of the money is always looked for. Capital payments, in fact, can only pass on costs from one firm to another. The money which is now needed to empty the shops, finally to extinguish costs, and allow the community to consume the whole product of industry, is "Income money," which individuals will be prepared to expend on consumable goods and not expect subsequently to recover again.

## CHAPTER III.

### *Incomes and Prices.*

It is the object of this thesis to show that (unless industry is expanding rapidly) the nature of our financial system makes it generally impossible for the total of incomes to be sufficiently large to buy the whole of the finished products which industry places on the market. It is, then, necessary to glance at what is the means of paying all incomes which are believed to be inadequate, and at the method of accounting prices which will appear to be too large.

It has been said that all the incomes which are used to extinguish costs are paid directly or indirectly by industrial undertakings, and will consequently appear as part of industrial costs. Although numerous incomes might come to the mind which at first sight appear to have sources other than industry, investigation will always show that the producing side of industry is in fact the agent through which all incomes are paid; though not, of course, the place of origin of the money. The stipend of a country clergyman, for example. This is paid largely from tithes, which are a tax upon agriculture, possibly still our largest industry. Were agriculture to fail completely, the payment of tithes would become impossible, as has recently been found in the eastern counties, and the stipend of the parson must cease or be paid by some

other branch of industry. Meanwhile this stipend is included in the price of agricultural produce.

Interest on Government stocks? These are paid from taxation—income tax in fact—and if industrialists made no incomes there would be nothing to tax, and consequently no interest on Government loans.

Foreign investments? This touches on the matter of foreign exchange, which is dealt with elsewhere, but the question of foreign investments can be easily settled by considering the industry of the world as a whole, which as yet has no dealings outside itself.

Insurance? The premiums are paid by industry. And so on with most of the other incomes you may think about.

Because most incomes can be shown to be paid through industry, and are included in industrial costs, it must be remembered that industry is by no means the place of manufacture of money. The money which is paid out by industry must first be placed there by the banking system, which we have already suggested has the privilege of creating money, and the business of a banker is to create this money in a manner which will be most profitable to his bank. From this it might be supposed that the incomes derived from banking would not be included in industrial costs. This, however, is far from being the case.

The bankers do nothing so crude as creating a million pounds and crediting it to their own incomes. Incidentally, industry would work far more efficiently did the bankers do this. But, in fact, all running expenses, salaries, and the dividends of shareholders

are derived from the interest drawn on loans, and the profits from sales of investments, the money for both of which appears somewhere as industrial costs.

Coming next to prices, these are the means by which industry attempts to recover all the payments previously paid out, all the incomes we have been discussing, and any other costs that there may be. Temporarily, I think, the latter may be disregarded, as most people will agree that all costs represent payments to someone at some time, although that time may be very distant. Indeed, some of the costs, though possibly only an infinitesimal amount, will have been paid out as incomes at a period so remote as to be before the present money system came into being. Any article being made in a factory of some sort must contain in its price part of the cost of building that factory, and consequently part of the cost of the tools which were used in the building of the factory, and so on into the remote past.

Not only are prices an attempt to recover all the costs previously paid out, there will be as well a margin known as profit. This can be classed as the remuneration producers receive in return for their work and organisation, and, as such, profit is as much a just cost to industry as the wages of the workmen. It is discussed at length later on, but meanwhile it should be noted that profits and some of the other costs of industry only appear as incomes after the goods have been sold. So not only do costs begin to grow a very long time before the goods are ready for sale, but there is also included in every price costs which will not appear as incomes till long after the

sale has taken place. Company reserves, for example, form part of costs which may never be anyone's income.

In investigating the manner in which prices are built up, it is sometimes convenient to divide the products of the various branches of industry into Primary, Intermediate and Final. Primary products are generally more or less as found in Nature. Ores, crude oil, trees, etc., are primary products, pig iron, fuel oil and timber being the equivalent intermediate products, and iron work, petrol, tables and chairs, etc., being the final results. It will be apparent that a final product under certain circumstances will be an intermediate one in others. A table may be a final product for a newly-married couple setting up house, but it is an intermediate or even a primary product for one who proposes to perform the service of keeping a tea shop.

An example often quoted in this connection is that of raw hides as a primary product in the production of boots. Leather is the intermediate product, and the boots the final one. Now all the costs of the farmer in producing the hides, as well as those of the tanner who tans them, must be recovered through the sale of boots. The smith who makes a scraper for scraping hides is starting a cost for a pair of boots. The tanner who dresses the hides will add to this cost, and, when he sells the tanned leather to a bootmaker, he recovers the cost as far as the tanner is concerned, but he does not extinguish the cost for industry as a whole; it is merely passed on as a cost to the boot manufacturer. He in turn will pay his men, allow for



his overheads, include his banker's and lawyer's charges, and any other expenses there may be. Till finally all the cost from the first smith to the last retail salesman will be included in the price of the pair of boots.

Not only such obvious costs as leather and the payment of wages must be recovered, but even such permanent investments as factory buildings will have been paid for by someone, and the costs of them must sooner or later be collected. This can only be done through the prices of the articles made in the buildings, and when buying a pair of boots it is interesting to remember that you are also paying for part of a factory.

I hope this has made it clear that all costs for primary and intermediate products, including plant, buildings and everything else, are included in the price of the final product, and that these costs can only be extinguished by someone paying the price of the final product and taking it away, so that it becomes destroyed.

It will be realised from the foregoing that at all times there must be in existence an immense total of costs which are being provisionally charged against consumers as a whole. Many of these costs are not expected to be recovered through the agency of prices of final products for some time to come, nevertheless the costs are there, and it is hoped to extinguish them some day. A transfer and payment for any goods passing between producers does not extinguish any of these provisional costs. The producer who sells the half-finished goods may have got his money and made

a profit, but the costs, which include the profit, are still outstanding for the public to pay. Only when a consumer is able to buy some final product will the sale extinguish any cost, but when he is so able, a long train of costs, like those involved in the sale of boots, is extinguished.

Now, what sort of money must a consumer use to buy the final products in which all the costs of industry are included? Readers may remember that before discussing incomes and prices we touched on the difference between capital and income money. Income money we saw can be used within the tenets of sound finance, in any way the owner pleases, but **once any money has been classed as capital, in whatsoever manner that money may be paid away it will never reduce the total costs as the fact of paying away capital at once creates costs to that amount.**

Consequently, to extinguish the costs of industry, it is only income money that can be employed. I hope the realisation of this difference between capital and income money will make it easier to see some of the causes of deficiency of purchasing power which lie at the root of our financial troubles.

## CHAPTER IV.

### *Deficiencies of Purchasing Power, Profits, Investments, Insurance, Deflation, Depreciation.*

There are, as might be suspected, several causes of the deficiency of purchasing power which is becoming increasingly apparent all over the world. In the past there have usually been means to compensate these deficiencies, so that over history their presence may have been less apparent than it is to-day, and this has led several economists into the belief that there is no deficiency of purchasing power caused by the working of the financial system.

What has happened in recent years is that the means of compensation have become no longer possible, so that the glaring anomaly of poverty amidst plenty has become a generally acknowledged fact. But before discussing the methods of correction employed in the last century, it seems preferable to glance at some of the causes of deficiency of purchasing power which do in fact require correction.

Several writers and propagandists have in the past called attention to one or other of these deficiencies, but no cause taken singly can really account for the facts of the situation, and many of the proposed remedies have appeared unpleasant to large and influential sections of the community. Consequently the ideas propagated have drifted off into the

realm of politics, and the truth or otherwise of the matter has become obscured.

Under this description are deficiencies caused by the system of remuneration derived from profits, interest, and rent, and an attack on these savours of our Socialist and Communist friends. I would therefore like, before discussing these particular causes of deficiency, to dissociate myself from any particular political group. Profit, interest and rent are relatively minor causes of deficiency, and I think it can be shown that there are remedies for the chronic state of deficiency of purchasing power which do not render the world a singularly uninteresting place by the absence of private property and profit.

Apropos of remedies, may I beseech you not to read that part of the book before being sure of the nature and cause of the disease which it is desired to cure.

Now a deficiency of purchasing power is the effect of a demand on the part of producers for money which consumers do not possess. The price demanded may be just in every way, but that is irrelevant. While consumers do not possess the money, the deficiency exists. A simple form of such a deficiency is caused through our system of remuneration by profit. A producer in the course of his business will distribute incomes in various ways, but when he tries to sell his goods he demands from the public all that he previously distributed, and more. As all producers are doing the same thing, where is this collective "more" to come from?

It is, of course, possible that the collective

“ more ” might be paid with entirely new money added to the industrial system for that purpose. Indeed, it has been pointed out by Major C. H. Douglas that “ The industrial system cannot operate continuously on a profit system unless new money is continually added.”

The truth of this can be seen by one of those examples which reduce the system to an extreme case. Suppose you and I form a community possessing between us one article and one pound (£). I can buy the article from you for the £, but however much I may improve the article, I cannot sell it back to you at a profit, as the £ is the only money in our system.

This is the true meaning of the old proverb that “ We cannot live by taking in each other’s washing,” a proverb often quoted at inappropriate moments by those desirous of fogging the issue.

Even the addition of new money cannot under our present financial system entirely solve the problem, as it is one of the most firmly established principles of that system that new money is never added except on condition of its being used for new production. In fact, all new money is issued as capital and cannot become incomes until the working capital is distributed as wages, by which distribution it creates further costs to be extinguished, so any deficiency of purchasing power is not permanently reduced.

A more simple solution to this problem of profit is sometimes attempted, which may be called the idea of alternative or progressive profits—*e.g.*, suppose the consumers have received as wages all the costs of production of two producers. They have, however,

not received enough to buy the whole of the products by the amount of the two profits. The consumers are thus faced with the decision of having to leave one product or the other partially unsold.

Some nineteenth century economists argue that this is a desirable state of affairs in that redundant producers are thus forced out of business. But it is again a fundamental error to suppose that, because a product remains unsold and is classed as overproduction, it is therefore not needed by the community. Both the products which we are discussing may be desirable or even essential to the people, and it is the fault of the financial system if they cannot obtain access to both.

In the example we are considering, consumers cannot obtain access to both products at the same time at a price allowing a profit to both producers, but under certain conditions (which do not hold in practice) they can obtain access to them alternately. Suppose they begin by buying one product at the price asked. One producer now has his profit, and, as a consumer, he can spend it on the other product, so that, although obvious delays are caused, if necessary, the profit could be passed on from firm to firm till eventually all had been satisfied.

This idea is upset under real conditions on at least two counts. Firstly, the whole of the profits are never distributed as dividends. Possibly more than half are put to various forms as reserve, thus immediately becoming classed as capital, and, whether invested or not, the money is again in the position of being unable to become incomes available for the

destruction of costs without at the same time creating further costs to be destroyed.

A second reason why the idea of passing on profits does not work in practice is due to the delay between the collecting of a profit from the public and its subsequent distribution as dividend to shareholders. As much as a year may elapse between the collection of the profit and its distribution as dividend. During that period numerous other goods have been finished in addition to those on the market at the time the profit was collected. All these latter expect to be sold at a profit, and even if the dividend should help to sell some of the original goods, further delay must occur before the money can help to sell new goods, and the flaw in the idea of progressive profits is that "the procession" can never catch up.

### INVESTMENT.

The investment of profits or wages is another cause of deficiency of purchasing power. We saw just now that it is only income money which can be used finally to extinguish a cost, whereas capital money will only pass on costs from one firm to another. If this point is fully realised, it will follow that, if any of the numerous incomes which go to make up the costs of industry are not used to extinguish costs but are transferred direct to capital account, then the amount of the incomes so transferred is left as a cost of industry which can never be extinguished, until, perchance, the reserve process takes place and someone voluntarily or involuntarily takes capital and uses it as income, a process not considered as "sound" in the best financial circles.

It is not difficult to see that numerous incomes do make this direct transfer to capital without the extinction of any cost. Small money savings by working men form one of these transfers, though, perhaps, a small one, and the capital thus built up runs a big risk of being spent on income account in times of depression, the much-discussed Means Test having been instituted to encourage this latter process.

A better example of this transfer is the system of building up a prosperous firm by the method of putting profits back into the business, as opposed to distributing them as dividend. The money which forms these profits, not having been distributed by the firm who collected them, is formed from money distributed by other firms, and consequently part of the products of these firms are still upon the market awaiting sale. If the money is now taken, and instead of being spent on consumption is used to increase working capital, it can only be distributed to consumers by the creation of further costs. Consequently there are in existence two prices and only one amount of money.

It is frequently supposed that in passing from hand to hand the same money can extinguish the amount of both these costs, but actually it cannot be so. This is due to the most important fact that a shopkeeper, when he takes income money over his counter, converts that money to capital, as he is then only recovering the capital which he expended or owed when he obtained the goods from a manufacturer. Certainly a portion of the money he collects may represent the shopkeeper's profit but at the most



this will probably be only 10 per cent., and spending by the shopkeeper will convert to capital a further 90 per cent. of this, so the whole soon becomes capital, and as such cannot finally extinguish any more costs.

If, then, any income is directly used to finance new production without first having extinguished any cost, such investment at once creates a further cost to be extinguished, and, as we have seen, there are two costs upon the market—*i.e.*, the cost created by the payment of the original income, and the cost of the new product. The money invested may have been distributed in the form of income, but this income cannot liquidate the amount of the two costs outstanding, as its spending upon one of them converts the money to capital; and should this be once more paid out as wages, such payment will create yet a third cost.

As an example, let us consider the case of an operative in a boot factory who carries on in his spare time a little poultry farming. Let us suppose that instead of spending all his wages upon boots or other consumables, he takes a Pound Note and invests it in the poultry business. The Pound Note has been paid to him as wages, and so forms a cost to the boot manufacturer. Let us call this cost No. 1. Let us suppose the boot operative, now turned poultryman, pays this Pound Note to an assistant as wages. If he attempts to run his poultry on business lines, those wages are now outstanding against the public as a whole, forming part of the cost to the poultry business, which must be eventually recovered by the sale of eggs, etc. Let us call this cost No. 2.

The assistant can spend his wages in extinguishing either cost No. 1 or cost No. 2, and, as it is the most recent, let him extinguish cost No. 2. The poultryman is now only recovering his capital; he cannot "dissipate" this upon consumables; and if he again uses the Pound Note to pay wages to his assistant, he will create a cost No. 3.

However many times the Note may be subsequently spent and redistributed, the amount of costs extinguished by the spending will always be re-created by the distributing, and if the wage earners always extinguish the latest cost, our original cost, No. 1, is permanently outstanding as a deficiency of purchasing power.

It will be realised that what the workman did on a small scale is being done every day on a much bigger scale by individuals and firms who desire to extend their concerns by the re-investment of profits and reserves in the business. Consequently there has been throughout financial history a gradual accumulation of costs like the No. 1 cost of the bootmaker, and it is small wonder that there are now signs of what is naively described as "over-production."

The building up of reserves is a further example of a direct transfer of profits, which might be considered as incomes, into capital in the form of investments. These transfers are made without the extinction of any costs, so the deficiency of purchasing power caused by the profit is left permanently outstanding. The money is invested through the Stock Exchange in Government loans or in the shares of an already existing company. In that event the seller of

the shares has the money, and in rare cases a speculator or a spendthrift may consider this as his income and spend the money on consumable goods. In general, however, I think there can be no doubt that the money which passes on the Stock Exchange is regarded as capital, and will only be used for the purchase of further securities or for production.

An experiment which you readers can try for yourselves in this connection is just to propose selling some of your own investments, if you have any, and spending the money as income. Then see what your solicitor, your banker, your broker, your employer, your wife, and the old friends of your family, will have to say about it. Many on this list really consider it morally wrong to spend capital money, quite apart from any question of prudence. Men have been known to be asked to leave a firm for less. Yet, in fact, such spendthrift action is beneficial to the community, as it will tend to correct the deficiency of purchasing power which is keeping industry in a state of stagnation.

### INSURANCE.

Perhaps the best and largest example of a deficiency of purchasing power due to a direct transfer of income to capital is caused by the activities of insurance companies. Insurance as a policy has in the last few years spread rapidly to all sections of the community. A hundred years ago few people would have heard of it, yet to-day almost every citizen has at least one policy and sometimes several. His life is probably insured, so is his house, his car and his clothes; possibly the education of his children, his

business; in the case of an actress her figure. A change of Government is sometimes covered by a policy, and so is the weather. In fact, the company which merely advertised sickness, death and other benefits was perhaps unduly modest in its offer.

Now, the premiums of these policies are invariably paid out of income, and in almost every case of a claim upon the policy, the sum received must be regarded as capital. Needless to say, there may be exceptions, but I think the above is the general rule. If a car is destroyed by an accident, the new one would probably not, in the case of a private owner, be regarded as a capital asset. But consider the case of a firm with a fleet of cars. In this case it definitely would be so regarded, and in most cases I think this is so.

A more important aspect of the matter is the case where no claim arises and the premiums accrue to the insurance company. Do they distribute the bulk of these as dividends? They do not. It is definitely the policy of insurance companies, as of banks, to distribute as little as possible, and to place to reserve as much as possible. Many insurance firms have eight figure reserves, and the total of insurance company reserves must be of the order of hundreds of millions, all of which represent income money collected from the public and transferred to capital without the extinction of any costs.

So large are the amounts that it might be supposed that an accumulated deficiency of purchasing power of this sort would have brought industry to a standstill long ago. It is certainly surprising that it has not done so, but the fact can be accounted for by

the continued expansion of industry, which has the effect of concentrating the bulk of costs in unfinished goods and enabling the incomes distributed for work on these to be available for the purchase of the finished goods. This process is explained in Chapter VI. Meanwhile there are other causes of deficiency which render an industry of constant extent impossible to work under the present system.

### DEFLATION.

A more usual method of financing new production than by savings is by means of new money created by the banking system for that purpose. It was in view of this that I touched just now on the possibility of money being created and destroyed. To some this may appear as a new idea, and others may have the conviction that money can only be made by hard work. Yet the making of money by hard work really means acquiring it from the rest of the community. Hard work can, with the assistance of Nature, make real things like a bushel of potatoes; but it requires some other agency to manufacture the pounds which are going to buy the goods. If this agency has not produced enough money, your potatoes will be classed as over-production and you will be unable to sell them, as many farmers who thought that hard work would "make" money have frequently discovered.

If I may yet again postpone for a time exact considerations of how money is created and destroyed, I hope it will now be sufficient to quote what has become a well-known axiom of banking—*i.e.*, that "every loan

creates a deposit and every repayment of a loan destroys a deposit." Now, as cash in hand and at bankers is what we use as money, if every loan creates a deposit it will be clear that if the banks are lending freely there will be more deposits, and therefore more money about, whereas if they are tending to call in loans there will be a shortage. "The amount of money in circulation" (to quote Mr. R. Mackenna) "entirely depends upon the action of the Bank of England in extending or restricting credit."

This aspect of the matter very materially affects the fate of the incomes which go to make up the price of any article. We know that many of the costs will have appeared as incomes a long time ago, and if the incomes were paid at a time when money was plentiful, and if, meanwhile, the money has been destroyed, it will not now be available to buy the goods.

The periods when banks are lending freely are called periods of inflation, and when they call in loans it is called deflation; the interval between times of maximum inflation being generally a matter of ten years or so. During periods of inflation money will flow from the banks quicker than it is recalled, and the plentiful supply thus released will be used to finance the production of large quantities of goods both intermediate and final. Money, of course, being only lent by banks on condition of its being used for production of some sort.

When, however, the reverse policy sets in, and loans are recalled faster than they are issued, a flow of money will start back to the banks from all producers who can sell anything, and as deflation is the

order of the day a proportion of these loans are not re-issued, so money tends to be destroyed (or locked up in the banks: the effect is the same). Nevertheless, there is still in process and finished, a large quantity of goods made during the previous inflation, and the money distributed during the manufacture of these being by now partially destroyed there is insufficient money available to buy them. Although they may be urgently required by consumers, they are classed by the bankers as overproduction.

As an example, consider the case of the boot industry, which is being made the standard example in this volume. Workmen taken on during the boom and employers earning good dividends will take the opportunity to renew their footwear, and the shopkeepers will order in more supplies from the manufacturer. These in turn seeing orders improving will consider it profitable to scrap their old machinery and order new from machinery makers, the re-organisation being kindly assisted by loans from the bank. The order for machinery also causes money to flow into the pockets of the machine makers, who also renew their footwear and for a time all goes well.

Now a reversal of banking policy sets in, and the manufacturer is tactfully pressed for repayment. Within the limits of the example he has no money in hand available for this purpose, as he will not yet have been able to recover the whole cost of the new machinery. But unless the symptoms of depression have become widespread money will still trickle in to the retailer, who will be able to pay the manufacturer for his last order, and having sold this stock, will

probably even repeat the order, which the manufacturer will deliver under the usual trade terms. But, under pressure from the bank, the manufacturer is now compelled to use the money received from the retailer to repay the bank loan, and the manufacturer's working capital is inevitably reduced by that amount. Consequently he must reduce production, turning off men himself, and owing to his being unable to purchase as much leather, etc., as before, unemployment in the tanning and allied industries will also rise. By reason of this unemployment, workmen will be robbed of their incomes and will be unable to purchase footwear or other consumables. The position is then as follows:—The retailer has a shop full of boots. The manufacturer has a shop full of new machines. But the workmen being out of work and the employers drawing no dividends are unable to buy the products they produced during the inflation. For a state of deflation to exist it is not essential for a reduction in the total of bank deposits to be shown by contemporary statistics. Any period, in which the rate of increase of money supply is less than the corresponding expansion of industry, will be deflationary.

One sometimes hears it suggested that the deficiencies caused by a period of deflation will be corrected by the following period of inflation. Unfortunately before a further period of inflation sets in the goods which cannot be sold will deteriorate in warehouses or become destroyed. The banks are actually, at the time of writing, lending money to finance the destruction of cotton and coffee crops! A subsequent period of inflation cannot recreate the



goods so destroyed. All that inflation can do is to cause a rise in prices while further crops are being grown.

A rather grim reminder of practical matters for those who talk of curing deflation at some later date, would be to ask them to "cure" the suicide of an unfortunate producer who has become bankrupt, not through any fault of his own, but merely because the capital which he distributed during the manufacture of his product was found to have been destroyed when he wished to re-collect the amount through sales. The connection between suicide and deflation is ably demonstrated on page 99 of "The Monopoly of Credit" by Major C. H. Douglas.

### DEPRECIATION.

In view of the arguments at the end of Chapter V. it is desirable to call attention to a rather obscure cause of deficiency of purchasing power arising from the item of costs known as depreciation.

Many of the public believe this to be a charge made for the use of buildings and plant so that the producer will have sufficient money in hand to replace these when they become worn out. Depreciation, however, can cover a good deal more than this, as it is often charged under various names upon stock-in-trade, which is continually turning over and cannot be said to wear out.

Any producer when setting up in business has to procure a certain amount of stock-in-trade. A tanner, for example, in addition to his plant and buildings, must always have on hand a supply of hides. Simi-

larly a bootmaker must have a supply of leather. All producers have to purchase these stocks when setting up in business, and if they are to remain in business they must maintain them. If the producers are content to remain permanently out of pocket by the cost of these stocks, then their costs are confined to wages and raw materials; but producers are not generally prepared for such contentment; indeed they are generally prevented from it by the fact of the money to buy stocks having been borrowed from some bank, who expect it, sooner rather than later, to be repaid. To enable this repayment to take place, all producers must in addition to the cost of wages and raw materials add a third cost, and there are no incomes available to meet this charge.

It is sometimes argued in respect to depreciation on plant, etc., that the incomes paid for work on new plant (to replace that existing) will be sufficient to meet the depreciation costs, but there is a diagram reproduced on page 76 which will show that this argument is unsound. Originally designed by Professor Hayek, this diagram has been adapted by Mr. F. F. M. Durbin and shows in simultaneous progress six stages in the production of bread. The total incomes derived from these six stages are only equal to the combined wages and raw materials cost of the final baker. All these incomes are derived from work upon new bread to replace that existing, and there are no surplus incomes to meet the depreciation charges which all six producers must add in addition to the costs shown. I submit that Mr. Durbin has overlooked this aspect of depreciation when drawing

up his diagram, and that in fact there must be a large deficiency of purchasing power from this cause.

In conclusion to this chapter it may be noticed that, included in the price of every article, is not only the total of all incomes distributed in connection with its manufacture. There are, in addition to this, the potential profit of the final producer, the reserves of capital considered desirable by all producers, and the amount of new capital development which it is proposed to undertake. In addition there will be the cost of numerous insurance policies, the amount of any money which has been destroyed by deflation, and all depreciation costs not covered by entirely new production.

The public have received no money in respect to the retailers' profit, or in respect to company reserves, or in respect of future capital development. They have no money to pay the insurance policies or depreciation, and they are liable to fourteen years' penal servitude should they attempt to replace the money destroyed by deflation. In consequence of this, the total of prices tends to be far above the money in the hands of the public, and it is not surprising that the present price system in industry shows signs of collapse.

I will attempt in the later chapters to show how disaster has hitherto been avoided, and the different methods which, I suggest, may bring about the permanent prosperity of industry.

## CHAPTER V.

### *The Circulation of Money.*

#### PART I.

There remains a more important cause of deficiency of purchasing power, which, to a certain extent, embodies those already discussed. This has previously been found difficult to follow or, at any rate, most people find it so, and the first discovery of this flaw in the financial system is a wonderful piece of original thought.

The amount of the deficiency thus caused is very large, so large indeed as to appear incredible when unsupported by statistical evidence. As in the end it is only by statistics that any approximation to the actual amount of deficiency of purchasing power may be obtained, so, once any cause of deficiency has been shown to exist, it is excusable to pass on to statistics without investigating further. But the statistics themselves are almost too startling for unsupported belief. These have recently been published by an association of American engineers working under the auspices of Columbia University, and appear quite incredible to those unacquainted with the theoretical investigations made by Major Douglas fifteen years earlier. When, however, their researches entirely bear out the state of affairs to be expected from the theory, it appears probable that both are correct, and it is easier to discuss remedies for the world's troubles,

On the question of deficiency of purchasing power, it was at one time an axiom among economists that the whole of any price represented income to someone at some time, and that, therefore, there was money somewhere to buy everything. While the first statement is at any rate an approximation to the truth, the deduction made from it is in no way a consequence. Indeed, once the matter is looked into it is a patent absurdity; but this is not yet fully realised by the public, and arguments are still put forward by, and on behalf of, various vested interests to try and show that industry does indeed distribute enough money to buy the whole of what is produced.

The understanding of this point can be shown to be of vast importance. Indeed it is not an exaggeration to say that the future of civilisation depends upon a rapid realisation of the true facts of the case. In view of this it is certainly to our interest to investigate how it is that the deductions of the old-fashioned economists may go hopelessly wrong.

The reason that so few incomes remain as incomes until wanted is quite simple. The circulation of money enables the same piece of money to form part of many incomes concerned. Yet, when the time comes for the goods to be sold, that money is only once available.

It is, perhaps, rare, though by no means unknown, for the same individual £ note to be paid out as wages more than once for work on any given article, but in this connection we must consider the whole of production together, and there will always be goods in process, or about to be in process, which will be all

finished at the same time.

The amount of the incomes paid out in connection with all this production will be the total price of the goods, and, unless the whole of the incomes are available soon after the goods are finished, there will be insufficient money to extinguish the whole price. We will see that it is not only probable but absolutely certain that the same £ notes, as well as bank money, will be used over and over again to make up the various incomes, and consequently when the goods are finished only a fraction of the incomes paid out in connection with them are available.

To follow more exactly the possible reappearance of the same £s in more than one of the incomes which go to make up the numerous costs of industry, we must look at the manner, and also at the rate of the circulation of money. It is to a certain extent fantastic to consider money other than notes as circulating at all, or, at any rate, circulating more than once, as, in general, money comes into existence by the granting of a bank loan and is destroyed again on the repayment of the loan. Also, any £s forming a deposit at a bank will lose their identity so that they cannot be distinguished again. Nevertheless, the circulation of money is a convenient fiction such as is often used in scientific analyses. If the repayment of one loan or the paying in of a private deposit is followed sooner or later by the issue of another loan or the withdrawal of the deposit, then the effect is the same as if the same £ had been paid into the bank on completion of one cycle, and then sent out again at the beginning of the next. As we proceed with the investigation I hope it

will be seen how convenient is this mechanism for looking at the situation.

At first sight it may also appear to be a large undertaking to investigate the journeyings of £s during circulation, as a given £ note may pass from hand to hand in almost innumerable ways, and it may be supposed that it would be impossible to unravel these ramifications. The £s we are concerned with, however, are those which accompany the production and the consumption of goods, or, in other words, which accompany the working of industry, and it will be found that in an industry of constant extent there are really only two main paths in which money can circulate. Any departure from these paths is sooner or later corrected by those who cause the departure being declared bankrupt. There are also only four simple stages in the circulation of money, and, as we also want to know the approximate time of circulation, we can, when following this, attempt to estimate for how long a time the money will exist in these states or periods.

If we begin to follow the circulation of money at the same time as some production is also starting, it is quite certain that we will find the money in some bank and that it will be classed as capital money. This will be the working capital of the producer, and if he should happen to be engaging in some entirely new enterprise all his capital will be in the form of money and he will have to secure his fixed assets as well. But as new firms must be the exception rather than the rule, it seems better when following the circulation of money to keep to some going concern.

The producer will pay out his working capital in various ways. Raw materials, rent, light, power, etc., and a certain proportion as wages. In following the circulation of money, which of these numerous payments are we to follow?

Now it is here that the flow of money divides into two distinct channels. The wages, salaries and that form of remuneration known as dividends, will flow on as the incomes of the community, whereas the other payments made by the manufacturer are repayments of capital to other producers of intermediate products, and money used for this purpose is on its way back to the bank as capital again. The circulation of this part of the money is then over. Having begun as capital in the bank it has returned to the same place and state. The income money on the other hand makes a longer circuit, and as this is the only sort of money which will finally extinguish costs it is desirable firstly to follow this branch of the cycle.

The producer will pay out income in the form of wages, salaries and dividends and, in doing this, a factory or other producing organisation has, in addition to its proper material function, the quality of converting capital into income money.

The time that the money is held by the factory is never likely to be longer than twenty-four hours, the notes for wages being probably drawn from the bank on the day that they are paid to the workman. In the case of salaries and dividends paid by cheque, the factory period will be of negligible length, as the amount will remain in the bank as the producer's capital until the cheques or dividend warrants are



presented, when the amounts will be instantaneously transferred to the income accounts of the officials or shareholders. Whether cash or cheques are considered, the factory period is negligibly short.

From the factory the money passes into the control of the workmen and shareholders, and enters what I wish to christen as the "pocket period." This will be the length of time during which people retain their incomes before spending them, and it will be seen that this period is probably not very long, as most incomes must be spent as they are received in order that the recipients may live.

There are undoubtedly people in odd speculative trades who will only receive money on income account once every few years, and must eke out the amount over that time, so that for these people the pocket period will be fairly long. Others receive their incomes annually, and if this is gradually spent over the ensuing year, it is not difficult to see that in this case the average period during which a pound remains "in pocket" is six months. Most people, however, even if not those with the largest incomes, receive their money weekly, and here the pocket period almost resolves itself into a matter of distances. The time will depend upon how long it takes the workman to get from the factory to his home, and upon how long it takes his wife to get from there to the shops. The average life of these incomes is a matter of hours. A realisation of the probable length of the pocket period is of great importance to the understanding of the financial system, and, without going further into statistical investigation, it will, I think, involve no

serious error to say that the average length of the pocket period is not a great number of weeks.

Having been spent, the money next passes to some shopkeeper and into the shop period of its existence; but this period will again be of negligible length, as shopkeepers do not keep the money taken over the counter in their own shops. The larger shops send to the bank daily and the smaller ones at least weekly, cash in any case being only the small change of industry. In the case of the important accounts which are paid by cheque, the length of the period is again infinitesimal, as the transfer in the banks' ledgers from one account to another is instantaneous. The point of interest in the change from the "pocket" to the "shop" period is that the money makes a change back from income to capital. With the exception of his net profit, the shopkeeper must regard all money taken in payment for goods as a repayment of the capital which he expended, or owed, when he obtained the goods from a manufacturer, and in this way a shop acts in the opposite way to a factory in converting income money back to capital again. The shopkeeper will now return the money to a manufacturer in payment for the same or for another batch of goods, so the money is again returned to a producer as capital, and the cycle is completed.

To estimate the whole time of the circulation of money we have still to try and ascertain the length of the bank period—*i.e.*, the length of time in which a pound may be supposed to lie in the bank after being paid in at the end of one cycle and taken out at the

beginning of the next. Fortunately the banks provide statistics which facilitate this calculation. The annual turnover of the banks to one significant figure is £40,000,000,000, while the amount of money in existence to the same degree of accuracy is £2,000,000,000. This means that every pound appears in the banks' accounts twenty times a year, or about once every two and a half weeks. There will, of course, be accounted in the annual turnover many transactions outside what we have called our bank period. Indeed the whole cycle will probably appear making four separate entries for the same amount of money. Against this it must be realised that by no means all pounds are taking part in this capital-income cycle, as a large number are used for purely capital transactions. If the removal of these pounds is set against the possible re-accounting, I think we are entitled to assume that the bank period of our cycle will again be only a matter of weeks. These will each be of a few weeks' duration, and without more precise information I think it will be found sufficiently accurate for the following argument to leave the subject with the supposition that the whole time of circulation of money is most conveniently measured in week, as opposed to years or other units of time. 19.

It might be suggested that the cycle just described is incomplete, in that the money we have considered began with one capitalist and probably ended up with

If the lengths of the factory and shop periods be taken as nil, then the time of circulation of money becomes the sum of the bank and pocket periods.

another. But it must be remembered that it is the adventures of the money we are considering, and we are not at present concerned with who should happen to own it. We have followed the money from capital in the bank back to capital in the bank, and although its next venture will probably be in connection with a different type of production than was the previous one, the cycle will be essentially the same.

It is usual nowadays for a large part of production to be financed by means of bank loans, so the capitalist throughout the cycle is almost always just the bank, and in any case the system of banking and bank loans renders all money fluid, in that any unit when in the hands of the bank may be paid out for any purpose; whichever depositor may have paid in the money.

The circulation of the money which appears as incomes may, then, be shortly described as—

Bank—Factory—"Pocket"—Shop—Bank,  
the money being income money and available for the destruction of costs during the "pocket period" between the factory and the shop.

Another objection which might be put forward is that this cycle is over-simplified, and that, in fact, any given pound may go through numerous transactions of the sort known as "Butcher-Baker" transactions—*i.e.*, a butcher receiving money in payment for meat may use the money to buy bread from a baker. These are the pounds previously mentioned as diverting from the cycle, and it is sometimes supposed that if this should happen, the same money may extinguish several costs.

While an individual Pound Note might possibly pass from hand to hand in this way, it cannot extinguish a pound's worth of costs at each change of hands. When the butcher receives money over his counter he is only recovering the costs incurred when he purchased his stock. The money received (less profit) must be regarded as capital and returned to the bank as such. If the butcher is in a hurry to buy bread, and borrows a pound from the till for this purpose, the payment of the note to the baker will extinguish the baker's costs to that amount; but the taking of the note from the butcher's till causes a cost incurred in the purchase of meat to become outstanding again; so that the butcher-baker transaction leaves the total of outstanding costs as before.

It is of the utmost importance to realise that the spending of an income can only once extinguish costs to that amount. Once the money has crossed the shop counter it becomes capital money, and, if production is to continue, this money cannot possibly be used for the purchase of further consumables and the extinction of further costs until the money has again passed through the productive system and so created fresh costs to be extinguished. In fact, when an income is spent, that particular money, as an income, may be considered as completely destroyed and can never again buy anything.

## PART II.

From this outline of the manner and time of circulation of money, we are now in a position to see more clearly how the circulation, or, more accurately, the rate of circulation, will entirely eliminate the possibility of the pounds, which formed the incomes paid out for work on earlier stages of production, being all available together when the money is required to extinguish the cost of the finished article.

If the time required to build up a price, from the first primary products to the final retailer's shop window, is longer than the time required for the circulation of money, it is possible for pounds paid out for work on an early stage of production to circulate as we have seen and to return to the bank, when they can be paid out again for work on a second or later stage in the production of the same article, or of another article in the same batch. A batch of production being all the articles produced by industry which will be put upon the market at the same time.

Comparatively few pounds may then be required to finance the production of an expensive batch of articles. But when the time comes to finance their consumption, a different problem arises, as, if an article is to be sold within a reasonable time of its completion, the whole number of pounds paid out during its manufacture must be in the hands of the consumer at the same time or he will be unable to pay the price. If, then, the same pounds have been used frequently to make up the incomes paid for production, there may not be sufficient pounds in existence

to pay out during a reasonable period incomes equivalent to all those paid out during the long time of price building.

We now know that the time of circulation of money is a matter of weeks, and we saw in Chapter III that the time required to build up a price may be very long, some of the older costs having possibly appeared as incomes as long as a century ago. To attempt to discover the number of circulations of each pound during the time of price building it would be necessary to know over what average time it might be assumed that incomes had been regularly paid out, as, of course, in practice the rate of payment would vary irregularly throughout the whole time of construction. To find such an average time would be a tremendous task and unnecessary for the purposes of this volume. It will suffice to say that while the length of such an average period may be less than the suggestion of a hundred years, it must also be far longer than the few weeks necessary for the circulation of money.

Suppose, then, to take a simple example, that money circulates in the manner we have seen, and completes the circulation in a period of about a month. Suppose again that the time required to make an average article is only six months. It is then possible to finance this production with a working capital of only one month's wages, and for the moment we can assume that this is the only money in existence. The pounds will then be paid out during the first month, will be spent on some existing articles, and, being re-collected by the bank, can be used to pay the wages

required for the second stage of production; and so on through six monthly stages. When, however, the time comes to try and sell the articles produced in this way, there is a deficiency of purchasing power of no less than five-sixths of the total price, as the money paid out each month will have been accounted into the price of the articles on each occasion of its paying out, and when the goods are finished there is only in existence sufficient money to extinguish one-sixth of the total costs.

Put into the terms of our old friend the boot industry, the position is similar. This industry will have a share of the total working capital of industry as a whole, and as this share will not be lavish, the money may easily be employed as follows.

The tanner, let us suppose, first uses the pounds, and he may pay them to a knacker in exchange for hides. The knacker in the course of his business will return the pounds to some bank, either in repayment of a loan or as a deposit, and the banker is now able to use the same pounds to make another loan or pay out another deposit withdrawal. The pounds thus paid out may now be used as wages for work on tanning hides, and passing through the shops may be again recovered to the bank, and may also be used by a boot manufacturer to buy the tanned leather, and yet again, after further circulation, to pay the men employed in bootmaking. Till finally the same pounds, by reason of their circulation, may have financed the boots all the way from the tannery to the retailer's shop window.

The retailer, wishing to put a price on the boots,



may ask the banker or a firm of accountants how many pounds have been paid out during the manufacture. Should the capital have been £100 and the circulations ten, the banker will reply £1,000, possibly naively adding that this amount has been paid as incomes to someone at sometime and that therefore the money will be "somewhere"; and if the retailer has any difficulty in selling his stock, it is due to his own inefficiency as a salesman.

I hope it has been made clear that this deduction on the part of the banker is entirely unsound, as only £100 has been used throughout, and this is all that consumers can use to extinguish the costs of £1,000.

Probably other industries will be in the same position, and over industry as a whole it should be clear that there is no question of the money paid out in the past being always "somewhere" and available to extinguish the price of finished goods. Not only have the incomes become capital through spending, and are therefore not available to extinguish costs, but I hope it has been shown that the money is not even "somewhere."

There is, however, a very valid objection to this reasoning—*i.e.*, that the case is over-proved and the deficiencies shown are clearly far too large to exist in practice, particularly as the circulations of money during the time of price building might be very many more than ten. This is because an important aspect of the matter has been left out, in that we have as yet only considered incomes paid out in the past as being available to buy finished goods, but, in fact, analysis of any actual sale will show that it is not money dis-

tributed when the goods were made that affects the sale, but money being distributed for work on goods to be finished in the future.

The fact of these deficiencies having been hitherto concealed, owing to the expansion of industry, leads producers to count upon selling their products, and as soon as one batch of production is finished they will generally start work upon another. The wages then paid for work on new batches assisting the sale of finished goods. Though it should be noted how vulnerable is this assistance to loss of confidence, in that if producers see any tendency for their goods to accumulate in shops they will cut down production, and the wages being paid for work upon new goods will be reduced. A system, in fact, which depends upon new production to sell existing goods is unstable, and instead of tending to correct its own errors, it will tend to increase them.

This unstable system is, unfortunately, the one at present employed, and when producers lose confidence other means have to be devised to induce them to carry on business. These means are discussed in Chapter IX.

Meanwhile, in our example of the boot industry, a painstaking critic might point out that if production upon a new batch of boots was immediately started, incomes would immediately be paid for work upon this new batch, and consumers could buy one-tenth of the boots during each time of circulation of money, and, after ten circulations, when a new lot of boots had been finished, they would have exhausted the original stock.

While this arrangement might possibly be satisfactory in the boot industry, it is not a very practical method of selling milk or fish to allow part of it to remain in the shops for a year or more. But there are, in fact, better ways than this of financing the production of milk and fish.

In the examples, we considered industry as working with the minimum capital necessary for production, and showed only one stage of production in process at the same time. But it is clearly impossible to put a proper supply of goods into the consumption market if the interval between the completion of one batch of production and the next is to be the matter of years generally necessary to build up a price. Some goods, like milk and fish, have to be supplied daily, and clearly, in this case, a different method of finance must be employed to that previously described.

To allow articles to be supplied daily, or during any period less than that required for the circulation of money, it is necessary to have many batches of production in process simultaneously, so as to finish a batch of production at short intervals. Most probably tanning, boot manufacture and boot retailing of different batches will be going on at the same time, and, provided the capital available is sufficient, wages for all of these can be paid out during the same pocket period, enabling three times as many boots to be sold as would be the case if only one process could be financed at one time.

If sufficient stages in the manufacture of new articles are in progress together so that there are incomes paid during each time of circulation of

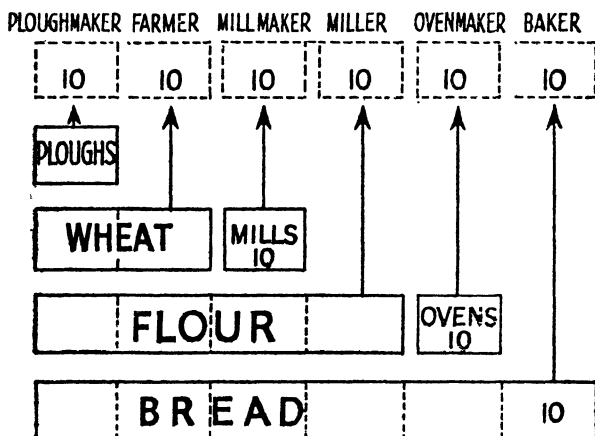
money sufficient to pay all the cost of goods finished in that time, then there will clearly be no deficiency of purchasing power. The pounds may then be regarded as financing the same process at each circulation and no pound will be used more than once in the same batch of production.

This is the situation believed to exist by Mr. E. F. M. Durbin, whose diagram showing such a situation is appended. This diagram has been freely copied by those who desire to prove that there is, in fact, no deficiency of purchasing power, and in various forms it has become the standard answer to the Douglas analysis.

Now, while admitting that many stages in the production of consumable goods must be in simultaneous process if the supply is to be kept up, there are other equally important stages which are by no means in continuous operation. Factories for the tanning of hides, shops for the retailing of boots, or railways and roads for their transport need only to be renewed at very infrequent intervals; yet overhead costs, representing part of the price of these necessities, are included in the price of every article, and, as the renewal of factories and so on is not a continuous process, there are generally no incomes being distributed to meet these charges.

Mr. Durbin has taken bread as the consumable from which he claims that all stages of production would be in simultaneous process. An article singularly unfortunate to his case as the sale of bread must be a daily problem. I would, however, like to take as an example a more average product

DIAGRAM I.



This is Prof. Hayek's diagram as adapted by Mr. E. F. M. Durbin for his book "Purchasing Power and Trade Depression." Mr. Durbin alludes to four stages in the production of bread, but actually six are shown, i.e.,

1. The making of ploughs.
2. The growing of wheat.
3. The making of mills.
4. The grinding of flour.
5. The making of ovens.
6. The baking of bread.

Each of these producers is shown drawing £10 as income for making bread costing £60. If these and other processes charged into the final price of bread are in simultaneous progress there would be sufficient incomes to buy each batch of bread as it is finished.

which, let us say, must be sold within a month of its being put upon the market or it will deteriorate and become unsaleable.

If the supply of these articles is to be kept up they must be replaced monthly or as sold and, for this to be possible, a chain of articles must be continuously under construction. There will, therefore, be paid during each month incomes for work on numerous stages of production, but not, I submit, for all. It is quite impossible that during every month new factories will be being built to replace those which are causing depreciation charges to be included in the price of the finished product. A factory once built may be expected to last for a hundred years and will make depreciation charges under one heading or another for a considerable part of that time.

The money distributed during the building of the existing factories will have been spent as distributed and may, as we have seen, be used to finance later stages of production. Nor can the money distributed when the factory is eventually replaced correct the accumulated deficiency of a century, as the articles concerned are perishable and must be sold monthly or thrown away.

Once again referring to Mr. Durbin's diagram, I submit that during the time available to sell bread there will generally be no payment to plough makers, or to oven makers, or to mill makers, and that if the plough, oven and mill factories were in operation they would not be replacing existing plant, but would be engaged upon entirely new construction representing an expansion of industry.

This possibility is discussed in the next chapter.

In view of this I submit that to maintain industry as a going concern, with all necessary replacements, there is no necessity to have all processes of industry in simultaneous operation; many of them will only distribute incomes at intervals too far apart to assist the sale of perishable goods, and in an industry of constant extent there is always a greater or less deficiency of purchasing power.

As a general statement on this problem I would like to put forward the following:—

Every article offered for sale must be sold within a limited time or it will perish and become unsaleable.

Every article for sale has included in its price the total of incomes paid out during manufacture, but these payments will have been made over a considerable period of time, and there can be no question of their having been saved and being available to buy the article now. It is incomes being paid for work on goods to be finished in the future which must buy existing articles if these are to be sold.

The numerous costs which make up the price of each article can then be divided into two classes.

*Class I.*—Those costs in respect to which income payments equivalent to those made during manufacture will be paid in the time available to sell the article.

*Class II.*—Those costs which have no equivalent payments made during that time.

To maintain a constant output from industry it is unnecessary to have all processes, which are charged into the final price, in progress during the time available for selling, therefore Class II. costs will always exist, and in respect to every article offered for sale there will be insufficient incomes paid to extinguish the price.

There are three corollaries which may be added to this theorem.

*Cor. I.*—If the output of industry is not constant, but is continuously increasing, there will be incomes being paid for work on entirely new articles, as distinct from replacements. It is possible for these to be equal to the Class II. costs of existing finished articles, and in that case there is no deficiency of purchasing power. It is owing to this expansion of industry that the present price system has hitherto managed to exist.

*Cor. II.*—Owing to the invention of machines, Class II. costs are tending to increase relative to Class I. costs, so that the rate of expansion of industry necessary to avoid a deficiency of purchasing power increases with the ease of production.

*Cor. III.*—The breakdown of the price system in industry is due to the impossibility of industry expanding at the necessary rate under modern conditions.



Incomes paid in the past are spent in the past and by spending become classed as capital which can never be employed for the reduction of total costs.

If goods are to be sold they must be bought with incomes distributed for work upon production to be finished in the future. If, then, they are included in present prices any of the cost of past production, e.g. roads, railways, factories, etc., there must be entirely new construction of similar undertakings so as to distribute income sufficient to pay this part of present prices.

Similarly, if it is attempted to add to present prices so as to collect money for future undertakings there are no incomes being paid to meet this addition to prices unless increased new undertakings are actually in progress.

It is contended that necessary replacements will not provide sufficient incomes to pay the depreciation charges on existing plant, and the cost of this, together with the amounts of new production intended to be financed out of profits, can only be met if industry is expanding rapidly.

## CHAPTER VI.

### *The Expansion of Industry.*

A better known general statement on the subject of deficiency of purchasing power is that drawn up by Major C. H. Douglas, to whom we owe the first general investigation of these problems, although some of these causes of deficiency have been discussed by other authors.

It may be recollected that in the previous Chapter on the circulation of money we discovered that there were two separate circuits that could be made by any given pound. We saw that when a producer took his capital and paid it out in the course of production, the income payments of wages, salaries and dividends took a circuit which may be summarised as: Bank—Factory—"Pocket"—Shop—Bank. On the other hand the rest of the money paid out was a repayment of capital to other producers, and made a shorter circuit of Bank—Factory—Factory—Bank.

It is on this double circuit of money that Major Douglas bases his theorem. It is really delightfully simple, too simple for most people, but the fact is that, while both these payments made by any producer are charged into prices, only one of them takes the longer path and is available as income. Consequently the total of incomes paid out is always less than the total of prices created by any production.

Put in Major Douglas' words, the statement is as follows: In any manufacturing undertaking the payments made may be divided into two groups:— Group A: Payments made to individuals, wages, salaries, and dividends. Group B: Payments made to other organisations, raw materials, bank charges, and other external costs. The rate of distribution of purchasing power to individuals is represented by A, but since all payments go into prices, the rate of generation of prices cannot be less than A plus B. Since A will not purchase A plus B, a proportion of the product at least equal to B must be distributed by a form of purchasing power which is not comprised in the description grouped under A.

This simple statement of the A plus B theorem has caused more heartburning in the world of theoretical finance than anything that has occurred for some time, but if the problem is considered quite straightforwardly on its merits it will be found to contain nothing beyond the comprehension of the ordinary individual.

Firstly, as to the significance of the theorem, it will follow that if the total of prices grows faster than the total of incomes it will be inevitable, as the prices gradually filter down into the consumption market, that the price of finished goods will get ahead of the incomes available to pay them, and a deficiency of purchasing power will be apparent; though it should be noted from the concluding words that there is nothing in the theorem to deny the possibility of a rapidly increasing production causing such a flow of wages being paid for work on intermediate products.

that these would be able to buy all the finished goods on the market at that time. But, if the deficiency is thus temporarily corrected, it will occur again as the intermediate products work down on to the consumption market, unless, perchance, the expansion of industry which caused the equilibrium is continuously prolonged.

Although it is clear that the effect of the A plus B theorem will be a deficiency of purchasing power, many people assume that the deficiency caused in any time will be the total of B payments made in that time. Truly a tremendous total, and it has frequently been remarked that were it 50 per cent. true the financial system would have collapsed long ago.

In regard to finished goods, which are, after all, what the public wants to buy, the retailer will certainly have very large B costs, as almost all a retailer's payments are made to other firms. But, to meet these B costs, are being paid the A payments of all firms who are making similar goods to be finished in the future.

As explained in the last Chapter, many people believe that the total of these payments will equal the total B payments of the retailer, but I attempted to show that this is by no means necessarily the case.

Such B payments as have no equivalent A payments will largely be grouped under depreciation, and may be taken to be an attempt to recover the capital that was lent for the laying down of plant, tools, etc. There is no likelihood that new plant similar to this will already be under construction.

Excellent examples of such B payments, with no equivalent A's, can be seen in the modern practice of

purchase by instalments. Consider a machine tool bought in this way. A few weeks after the completion of the tool the last of the money distributed in its manufacture will have been spent and become no longer available to extinguish costs. Nevertheless the instalments have to be met monthly, and form a typical overhead or B cost in the price of the final products made with the tool. Now, is there any reason to suppose that a similar tool is already being made to replace the existing one? Clearly not, as the tool will be expected to last for some years. So there are no A payments equivalent to his B cost and no means of extinguishing the price, except at the expense of money distributed by other firms and so required to buy their products.

Yet from observation of actual production it may not be very easy to see that no replacement of this tool is in progress, as makers of tools will, at any rate, attempt to make their business continuous, and it might be possible to find many such tools in course of manufacture. The reason for this is generally that the new tools are not merely replacements of old, but are to be fitted into entirely new factories, and represent an expansion of industry which is a very important aspect of the matter to be immediately discussed.

The previous chapters have been devoted to showing that industry does not normally distribute sufficient purchasing power to enable consumers to buy the products of industry as they are finished, but it will be clear that unless the flaws outlined are corrected in some way, no producer would be able to

sell his product and industry would become impossible.

The possibility of there being some factor to correct the deficiency of purchasing power might have been expected from the concluding words of the A plus B theorem, which are frequently overlooked by both friends and critics, the latter boldly stating that 'If the A plus B theorem were 50 per cent. true, the industrial system must have collapsed long ago.' But, as is plainly implied, there is a way out of the difficulty, the chief value of the figure of 50 per cent. here mentioned being to show what fraction of the theorem has been read by those critics.

When we say that industry does not normally distribute enough purchasing power, we have assumed that industry is constant in extent, whereas, in fact, from the earliest times until to-day, the extent of industry has been constantly increasing. Owing to this expansion a larger proportion of incomes will be paid for work on intermediate products than would be the case if the extent of industry were constant; and as the price of these intermediate products is not yet upon the market, the incomes being paid for them might be sufficient to buy all the finished goods.

For example, while instalments were being paid for the machine tools previously quoted, there might be another tool in process of construction, not for replacement of the first tool, but to be fitted into a completely new factory. Incidentally it should be noted that the construction of one such tool is insufficient to distribute wages equal to the instalments on the old tool, as all the costs of the new tool are not

wage costs. To enable all depreciation charges to be paid by incomes, there must be for every tool in existence two or more tools in course of construction, so as to distribute wages at the necessary rate. But with an expanding industry there is no theoretical reason why there should not be two or more tools under construction, and, if industry is expanding at the necessary rate, there might be sufficient incomes being paid, not only to avoid a deficiency of purchasing power, but also to allow a good profit to all producers, and even provide a margin for private investment as well. But, for this to be possible, it is essential that the rate of expansion be very large, and that it be financed with new money created for the purpose.

Inevitably, sooner or later, the price of these new production goods will come upon the consumption market. But if the expansion of industry is continuous, it is possible that a yet further flow of incomes, being paid for work of yet further intermediate products, might again be able to buy the finished goods, and, with a continually expanding industry, it is possible to make the system work; or, rather, it was possible when the necessary rate of expansion was far less than it is to-day, and when the world was not already filled with production goods.

Let us now, however, suppose a time in which the wages, salaries and dividends paid out as incomes are collectively equal to the price of finished goods put upon the market in the same period. We have seen that it is a reasonable approximation to say that the incomes paid out in any month are not paid for work on goods finished in that time, but will

generally be paid for work on other goods to be finished in the future. It is not, then, difficult to see that if the wages paid, say this month, for work on new goods, are sufficient to buy the products finished this month, then the total price of these new goods when finished will be greater than the wages which are this month being paid out in respect to them, as already included in the price of these new goods will be numerous overhead costs which are not incomes this month. In consequence of this, when the time comes that these new goods are ready for market, their total price must be greater than that of the goods finished this month, and if the total of wages is to keep pace with the total of prices, an increasing amount of production must be undertaken each month.

A constantly expanding industry is not a very difficult condition to fulfil if that is all that is necessary for efficient working, as expansion must be the natural direction of industry as new methods and inventions are introduced. But when the rate of expansion necessary to avoid a deficiency of purchasing power is investigated, it is found that the rate under modern conditions is far greater than what may be described as the natural rate of expansion due to increased populations and to new inventions and discoveries.

We have seen that, if final products are to be sold before they deteriorate in the shops, industry must expand sufficiently fast for the wages, salaries and dividends paid out in that period to be sufficient to pay the whole price of everything finished during the



same period. If we now imagine industry to produce only one type of article of average consistency, there must be, to pay the price of each of these, sufficient new articles in process for the wage costs of the new articles to be equal to the whole costs of the old ones, this latter being equal to the wage costs plus overhead costs of old articles.

This brings us to practical costing, for this is usually done by finding the wages cost and adding some factor as an estimate of what is known as overheads. If any of you have experience of practical costing, you can make the estimate for yourselves in connection with your own firm. If unable to do this, I will tell you that under modern conditions overheads are seldom less than 100 per cent. of wages; sometimes they reach 500 per cent., and occasionally as much as a thousand! This means that for everything now for sale there must be in process, in addition to replacement, one, five, or ten articles, according to which of these estimates is nearer to an average overhead charge. In point of fact, an average modern overhead charge is of the order of 125 per cent., so to enable everything to be sold, industry must increase its extent 125 per cent. during the time of price building, and, even if this is a matter of years, the rate of expansion of industry necessary to avoid a deficiency of purchasing power is still very large.

The expression "overhead costs" is used somewhat loosely, and perhaps depreciation would be a better single word description. The conception of what constitutes overheads varies greatly from one

firm to another. In some cases even wages are classed as overheads, on the argument that the staff must be employed in any case whether orders are coming in or not. It might also be pointed out that no account has been taken in the previous argument of the cost of raw materials, but it must be remembered that we were trying to imagine an average article made by the whole of industry. In this case raw materials can also be divided into wage costs and overheads, the division being really the same as the Class I. and Class II. costs of the general statement.

Now we have seen that the rate of expansion of industry necessary to avoid a deficiency of purchasing power depends upon what proportion of costs are formed by overheads, and it will be realised that, in the days when most things were made by hand, the necessary rate of expansion would be far less than it is to-day. Clearly, every time a man is replaced by a machine, a wage cost is replaced by an overhead cost, which is usually a Class II. cost, and in the days of hand work Class II. costs would be rarer than they are to-day, and the necessary rate of expansion would be less. So much was this so that the normal expansion of industry, due to increased population and the invention of new luxuries, may easily have been sufficient to keep the system stable, the chief problem being the age old one of "where is the money to come from?"

If industry is to expand, the money supply must expand at the same rate so as to finance the production and ensure the distribution of the increased supplies.

Always, however, those who have secured the monopoly of the manufacture and leasing of money have considered it in their interests to keep the supply of money dependent upon the supply of silver or gold that can be wrung from a reluctant Nature. That is why the historical periods of prosperity and expanding industry have always followed new finds of precious metal, and it is of interest to note that new fields (probably long known to financial interests) are now being "discovered" with a view to relieving the present depression in the same way.

The problem of the past existence of industry then becomes a question of seeing how nearly the money supply expanded at the necessary rate, and to study this it is necessary to understand the methods employed for the creation and destruction of money, which are explained in the next Chapter. Meanwhile the secret of the continued expansion up till the present day can be disclosed in one word.

In the beginning of this section of the book it was suggested that the reason why the people did not buy more than a fraction of the potential product of their industries was simple. It was because they had insufficient incomes to allow them to do so. The fact that they have bought far more than might have been expected from theoretical considerations is equally simply explained. The explanation is DEBT!

According to the foregoing analysis, the debt must be enormous. It *is* enormous, and it would be quite a simple, if laborious, task to add up the total loans floated in pounds which are still outstanding. I am

not going to attempt to do so, as, if it is clear that the amount is sufficiently large to check the foregoing analysis, figures are immaterial. A glance at a Stock Exchange directory will show that there is practically no country, no dominion or dependency, no State, county, or large town, in the world, which does not have loans of various sorts measured in pounds. These are often popularly supposed to represent money, but we know that this cannot be so, as the total of the loans will exceed very many times the total number of pounds in existence. In addition to these external loans, there must not be forgotten the internal National Debt of £8,000 millions odd, which has mounted since before the days of Queen Anne, and there is probably as much again of debentures, mortgages, and bonded indebtedness of various sorts.

A total summation of these amounts, together with the losses through bankruptcies, and so on, not forgetting the value of goods wasted and destroyed, would represent the amount of the accumulated deficiency of purchasing power, and I think the figure, if written, would be an adequate answer to those who argue that industry has got along somehow in spite of the deficiency!

There is one more point of interest before closing the Chapter. We owe this enormous debt. To whom? Obviously not to each other, although small fractions of the above securities are undoubtedly held by private persons, and the proportion so held represents money which some unfortunate producers had hoped was going to buy their product. I hope you will not think that the bulk of this debt will

represent saving on the part of the public, as the last three chapters have been written to show that it represents, not saving, but an approximation to the price of goods which have been bought but not yet paid for.

THEN TO WHOM, IN GOD'S NAME, DO WE OWE THESE SUMS?

## CHAPTER VII.

### *The Creation and Destruction of Money.*

If we may begin this Chapter by revising the last, we find that the present situation appears to show that the people as a whole have insufficient incomes to buy what they have produced. We examined one or two theoretical considerations which accounted for this, and found that the main cause of deficiency of purchasing power is the rate at which incomes were converted into capital by spending, and that, once they had been so converted, the money could only be used for further production and the creation of further costs, this rate of destruction of incomes being far greater than the rate at which costs can be extinguished—*i.e.*, the money paid for the building of a factory is all spent and becomes capital within a few weeks of the completion of the building, whereas the cost of the factory may take years to recover through the depreciation charges put upon the price of the articles made in the building. Industrial producers and honest capitalists are in no way to blame for this, and are fully entitled to try and recover these costs. Once more to quote Major Douglas: "The only objection to this perfectly fair assumption is that, in the aggregate, the public have not got the money."

We saw also that under modern conditions the deficiency can only be made up by a quite impossible

rate of production, although the day when the deficiencies must be correct has been postponed by the time-honoured method of getting into debt.

The next problem to investigate is, "How did this debt arise and to whom do we owe the amounts?" and to see this it is necessary to go further into the methods employed for the creation and destruction of money.

Early in this book we took a simple definition of money as "Cash in hand and at Bankers," and I see no reason to enlarge upon this definition. Cash in hand consists, firstly, of the silver and copper coinage which is the only part of our money which is issued by the Crown. It is manufactured by the Mint from the ingots of metal, and although these coins are made under the authority of the Treasury, it is difficult to imagine the officials acting independently of the Bank of England, who manufacture the rest of our money. If the Bank require coins to use as small change, they will order from the Mint a number of coins of various denominations, and pay for them by crediting the Government's account. The coins only form a very small part of our money supply, in fact, something of the order of 3 per cent.

The Bank Notes are issued by the Bank of England. They arrange to have them printed and, if for any reason they wish to increase the amount in circulation, they can use these to pay for goods bought or services rendered to the Bank, thus securing goods and services for the cost of the printing.\*

\* In this country the profits of the issue department of the Bank of England are paid to the treasury.

The number of notes which the Bank can put into circulation is, however, regulated by law to an amount equal to the legal value (84/- per ounce) of the gold held by the Bank, with, in addition, a Fiduciary Issue, which at the moment is £760,000,000, but is altered occasionally by arrangement between the Bank and the Treasury.

Actually the number of notes in circulation is regulated more by the public than by the Bank, as it is a matter of their convenience whether they prefer to deal in notes or by cheque. As might be expected, the public generally ask for more notes at holiday times, but it is only under exceptional circumstances that the full legal value of notes would be in the hands of the public. The value of notes and coin will be about 20 per cent.\* of the whole money supply.

These notes, and the silver and copper coins, form the cash in hand of industry; it is balance at bankers which forms the important part. These latter pounds consist of entries in the banks' ledgers, and if this should be difficult of realisation, consider the matter in the light of an entry which said, "Mr. Reader, credit, £1,000,000." This I am sure would be a most effective form of money.

Money of this sort is transferred by cheques, which are letters from a depositor to his banker asking for the entries to be altered so that the depositor's credit is reduced and someone else's credit is increased. Actually nowadays many people keep debit accounts or overdrafts, and in that case whoever writes a cheque

\* When turn-over is taken into consideration less than 1 per cent. of transactions are made in notes and coin.



asks for his debit to be increased and the debit of someone else to be reduced. Provided the banker approves of this alteration, or, if the account is in credit, whether he approves or not, he will order a clerk to make the necessary alterations, and this transfers the money just as effectively as if notes had changed hands.

As there are several banks operating, it is possible that a cheque might be made out in favour of someone who kept his account at a different bank to that of the writer or "drawer" of the cheque. To deal with this situation, the bankers have an Association called the Clearing House, where the cheques are sorted out, and it is found that the cheques in favour or disfavour of the various banks largely cancel each other, and only a balance has to be transferred from one bank to another. This is done by altering the ledgers at the bankers' bank, *i.e.*, the Bank of England, where all banks keep their accounts.

The methods by which this deposit money is created and destroyed follow from the manner of ledger alteration. We have seen that money at a bank is a credit entry in their ledgers, and they will in response to your letters or cheques transfer this money or credit (they are the same thing) to anyone you care to name. All this involves is an alteration of the ledgers. If another bank is involved, then the ledgers at the Clearing House and the Bank of England are perhaps altered, as well as those of your bank, but in any case the whole transaction is a matter of paper and ink.

Now, when you have transferred the whole of

your credit to other people, what do you do next? You have probably done this in pursuit of your business, which may show every sign of being prosperous but for the fact of your having no money to continue it. Perhaps, if you ask your local bank manager nicely, he will allow you an overdraft, and you will be able to go on writing cheques as before. But what will now happen to the ledgers? The clerk cannot go on deducting the amount of your cheques from your account as this has become zero, and whatever may be done in mathematics, you cannot, in fact, take anything away from zero. I have used this analogy before, and do not hesitate to do so again. You cannot have less than no bricks in a field, less than no food in a larder, or less than no pounds in a bank.

You will owe the money to the bank, you say? Quite true! But does not the word "owe" imply a future transaction? The fact that you will be able to buy a meal on Saturday does not lessen your present hunger. Till the account is placed in credit you still have no money in that bank.

But what of the people to whom you made your cheques on the overdraft payable? The amount of these cheques must have been added to their accounts as usual, or they would soon find out and have something to say about it. These people have that much more money to use as they like, and you, still being penniless, there must be that much more money in the world.

The bank is poorer, you say? It may be, by the amount of your cheques which were paid into other

banks; but that is a matter which the bankers can easily settle among themselves by the simple process of altering the ledgers at the Bank of England. The point is that the whole of your overdraft has been added to someone's deposit in some bank, and so the total of deposits, and consequently the amount of money in the country, is increased by that amount. This new money will facilitate the expansion of industry, and that is why the times when banks lend freely are usually prosperous.

There is a limit to the amount which the banks can create in this way, though quite an arbitrary one which can be altered at any time. In case a number of people want to take their money in legal tender—*i.e.*, notes, whose number is limited by the Government—the banks do not like their deposits to rise above the point which will allow them to have 10 per cent. of deposits in the form of "Bank cash," bank cash being notes and balance at the Bank of England. In what proportion these will be kept my banker friends are reluctant to tell me, but I doubt if in general a bank would have more than 2 per cent. of deposits in actual cash on the premises. An interesting thought that; although legally compelled to pay in cash if asked, the banks have only something like 2 per cent. on hand, and if 2 per cent. of depositors were to ask for cash together, the bank is technically bankrupt. Needless to say, they could obtain extra supplies from the Bank of England at short notice.

The amount of bank cash will depend upon the overdrafts at the Bank of England. It is unlikely that the large Joint Stock Banks, where you probably

keep your account, will overdraw, as, were they to do so or ever seriously to deplete their balance at the Bank of England, the proportion of bank cash would upset, and there would be a panic among the officials until things were put right.

There are, however, numerous other firms and individuals who keep accounts at the Bank of England; queer firms in the City who perform odd services, real or supposed, like the rediscounting of bills, or bullion broking, or foreign exchange dealing. All these will gladly overdraw if the Bank will let them; indeed their living probably depends upon being able to do so. Not only hundreds of firms like this; but, of course, the British and Foreign Governments keep accounts at the Bank of England, and the British Government's account is frequently hundreds of millions overdrawn.

I hope it is clear that all overdrafts are new money, and the new money created by overdrafts at the Bank of England will be paid away to various people, and eventually find its way into the Joint Stock Banks, whose accounts at the Bank of England will get written up accordingly, and the Joint Stock Banks will consider this as bank cash. Consequently they can now accept deposits to ten times the amount of the new bank cash, and so can create new money to that extent. Hence Mr. R. McKenna's statement that "the amount of money in the country depends entirely on the action of the Bank of England in restricting or expanding credit."

The recalling of loans causes an exactly reverse process. If people owe the bank money and are

pressed for repayment, they must sell something and secure the money. By selling this they acquire cheques from other bank depositors, and these depositors are reduced by the price of the goods sold, but when these cheques are handed to the lending bank no deposit is increased. All that happens is that the overdraft is reduced, and the result is that there is that much less money in circulation. Similarly, repayment of loans to the Bank of England will reduce bank cash.

What policy the Bank of England will follow in this creation or destruction of bank cash, and so of the amount of money in circulation, will depend primarily upon the whim of the Governor and Court of Directors, acting ostensibly in the interests of their shareholders, whoever these may be; not, be it noted, upon the needs of industry. They are, however, governed, or profess to be governed, by the working of the gold standard and the gold basis of money, these two being often confused. The gold standard, being suspended, is no longer of great interest, but its essential feature was a promise to buy or sell gold at fixed prices; a promise which the Bank of England has had to withdraw at various times, the last occasion being in the autumn of 1931. This was done not because all the gold was sold, but because, on the gold basis, the reserves had become, in their opinion, dangerously low.

This question of retaining a gold reserve while no longer on a gold standard can only be classed as an idle superstition. The Bank will not sell the gold or circulate it as currency, so it cannot possible matter

to this country or anybody else whether there is in the vaults of the Bank of England gold to the value of 10 per cent. or 9 per cent. or 2 per cent. of the value of our currency. Nevertheless the banker attaches importance to this, and the supply of money would still be restricted in this country because the gold reserve was low.

While in general there is probably no real limit to the amount that the Bank of England could create by the extension of credit, readers may have heard the complaint of bankers in recent years that "they have never refused a loan to any genuine borrower who could provide the necessary security." That is just the trouble. The genuine borrower with good security is a producer, and he does not wish to borrow money for further production till the goods he made last time have been sold. These goods cannot be sold till more money is in the hands of consumers to buy them. But consumers cannot get more money until producers start producing again and pay out some more wages.

The way to set industry going again would be to find a way of lending or giving some new money to consumers, so that they could buy the goods they want and set the wheels of industry going again; literally, wheels going again, as the factories would at once start to replace the goods which had at last been sold. Producers would then be glad to borrow money, or could use that which flowed back to them from the consumers.

Remedies for the present discontents are fully discussed in a later Chapter, meanwhile there is

another and most significant way in which the banks, under the supervision of the Bank of England, can increase or reduce the money supply. This is by the purchase or sale of property and securities.

A simple example will serve to illustrate this. Suppose a bank to employ a builder to erect new premises for them in some country town. When the job is completed, the bank will owe the builder some thousands of pounds. It will not be difficult to persuade him, as a local man, to open an account at the new branch. The builder can then be paid for his work in erecting a palatial building by the taking of a pen and writing clearly on the first page of the new ledger, "Mr. Builder, credit, some thousand pounds."

The builder can now spend this money as pleases him (though it will be capital), and he can with his cheque book distribute it all over the town and country. The bank will then be put to the trouble (I had nearly said expense) of employing clerks to keep the ledgers up to date and keep a note of who has the money at the moment!

The important point to realise is that the money system, which has been employed in this country for at least a century, is merely a system of book-keeping, and the supply of money is increased or decreased by a stroke of the pen. It is an excellent system, but there is nothing sacred about it whereby it cannot be altered were it found desirable to do so, and in view of this it is clearly ridiculous to destroy any goods which may be needed by the people, and even to destroy the means of production, as has often been

done under the guise of rationalisation, because of figures in a ledger. The figures, on the other hand, could be easily altered to reflect the facts of production, yet there seems a sort of mass hypnotism which makes the banker shudder at the suggestion that the books could be kept on some other method.

It is, perhaps, a hard realisation that the money for which we have fought and struggled all our lives is nothing but these figures, and, needless to say, the mass hypnotism, to which I alluded, is by no means confined to bankers. Its effect is frequently to make people very angry when the simple truth is presented to them, but readers must judge for themselves and agree or dissent according to their various temperaments.



## CHAPTER VIII.

### *Loan Finance.*

Keeping in mind our knowledge of the methods of creation and destruction of money, we are now in a better position to account for the continued existence of industry, which at first sight appeared impossible in view of the numerous causes of deficiency of purchasing power, which we investigated in Chapters 4 and 5. We have already suggested that the goods had been largely exchanged for debt, and it was pointed out that much of this debt was owed from abroad.

The fact of the existence of these debts needs no proof. It is not a great exaggeration to say that there is scarcely a firm which is not run on an overdraft to-day, or else on money obtained by the issue of debentures. There is no municipal or other public body without a public debt up to the limit upon which they can pay interest, and any expansion of industry within the town or country borders is invariably the excuse for increased borrowing.

This loan of pounds is not confined to this country. There is scarcely a town or country of any size in the world which does not owe pounds to the City of London. The total, as previously stated, is too stupendous for comprehension, and I have avoided the labour of its addition. Nevertheless a few extracts

from an old Stock Exchange directory, opened almost at random, may be of interest to bring home to readers the state of affairs.

First on the list of Government Securities I find Aaharus (Denmark), who were in 1910 granted a loan of £500,000. They have repaid some of it, but £343,300 was still outstanding when my list was published. It is of importance to note that this loan is in pounds and not in the Danish currency, as this shows that the loan was raised in this country.

Next on the list is Aberdeen, a city justly famous for astute finance, yet they appear to have had to live beyond their resources to the extent of four million, one hundred and seventy-four thousand, six hundred and forty-three pounds!

Third on this role of penury is Abo (Turku), City of (Finland), who owe the convenient round figure of £500,000. A little later in the alphabet comes Astrakhan, whose mode of dress has often been associated with financial transactions, yet their share of British goods exported on credit is the comparatively small one of £559,396.

Turning the pages more quickly, we find Balem, see Para; and, of course, Belgium; and Bello Horizonte and Corrientes and Dun Laoghaire. Later on are Styria and Surrey, and finally, after two hundred and thirty closely printed pages, the list of debts ends with Wynberg, York and Zurich. The total of these loans—and remember we have not touched on mortgages, debentures, etc.—would, indeed, be stupendous, and if anyone with more patience than I cares to add up the amount, I shall be very pleased to hear the result.

It is now necessary to investigate the significance of these loans, and try and see more exactly how they have enabled industry to exist in face of the deficiencies of purchasing power previously discussed.

In the first place, what do the loans represent? They are an admission of debt on the part of the various public bodies concerned, and either the public bodies have received pounds and propose to pay them back some day, or else they have received goods and hope to pay for them some day. In the latter case it is difficult to see how the manufacturers of the goods concerned could afford to send away such a large total without recovering any of the costs incurred in manufacture, so we are forced to the conclusion that the public bodies were lent pounds, and with them paid the manufacturers for goods. It must be noted that it was British manufacturers who benefitted in this way, as the value of a pound rests solely upon the quantity of goods that it will buy in Britain, and, ultimately, it is only for the purpose of buying British goods that anyone will accept a pound in exchange for any other currency.

It is certain, then, that British goods were sold and exported in exchange for the pounds that were lent, but the question remains as to who can have provided the pounds to this amount and who can afford to wait almost indefinitely for their money? The word "indefinitely" may require explanation, as a few individual loans of this class are from time to time repaid. Yet cash repayment is rare, the usual methods employed being to issue another loan for the purpose of repaying an earlier one, or to make a direct

conversion operation, as was done with the 5 per cent. War Loan in 1932. In any case, during the time between the issue of one of these loans and its repayment, at least two other loans will have been made. Who, then, can afford not only to wait indefinitely for the return of their money, but also continually to increase the total of debt outstanding?

It is often loosely supposed that these pounds were subscribed by the people of this country, but it clearly cannot have been so, as had they been in a position to lend money abroad, so as to enable the foreigner to buy British goods, would they not rather have purchased the goods themselves? It is irrelevant to suggest that the goods were more suitable for foreign than for home consumption. The fact that these goods were made for export merely shows that our manufacturers had a shrewd idea of where their markets were going to lie. Nor is there any question of these goods having been exported with a view to exchange for more suitable foreign products, as in that case there would be no debt outstanding.

From a national point of view, the only exchange made for these goods has been an intangible admission of debts. The vast foreign loans outstanding represent goods which have been exported and for which the only return has been a promise to pay pounds as interest to the holders of the stock. An optimistic promise in many ways, as the people who make it have no control over the manufacture of pounds, and they and their creditors may easily be let down if those who have this control should happen to have provided an inadequate supply of pounds, or

have placed the available supplies elsewhere.

Although it appears unlikely that the total of the loans were subscribed by the people of this country, it is, nevertheless, well known that some of the securities are held by private investors and firms, and we have seen that large amounts of money, which may be broadly classed as company reserves, accumulate in the form of capital and cannot be spent upon consumable goods. The money can, however, be spent upon further production or be invested in good class securities, the latter covering most of the loans we are discussing. Private investors too, who have been fortunate enough to acquire money by inheritance or other means, are often prepared to part with it almost indefinitely provided they can find someone to pay them interest on the amount.

The condition of paying interest on these loans has a most important consequence, as the fact that interest must be earned on the money means that the goods bought must be capable of earning interest, or, in other words, shall be of a capital nature. Indeed, the loans to foreign and colonial governments are frequently described as development loans, and are used to assist the country concerned to construct such capital assets as harbours and railways, and to import machinery. It is by making a charge for the use of all these that the interest can be earned.

It was inevitable that this export of capital goods during the nineteenth century would one day cause competition in the consumption market, and it is, perhaps, a little galling to think of prosperous Lancashire manufacturers, early in this century,

investing some of their large profits in Japanese Bonds, through whose assistance cotton machinery was exported to Japan and is now competing with Lancashire.

Now, another statistic which can be checked, but which I would like meanwhile to take on trust, is that the total of reserves of industrial companies and the capital of private individuals totals nowhere near the amount of the loans outstanding. In view of this and of the privileges of the banking system to the creation and destruction of money, it is only to them that we can look for the origin of the money which financed the export of our goods.

There are, however, still several outstanding facts to be cleared up in connection with these loans. In the first place, what has become of the money? If pounds are lent by one individual to another, or are created by banks and lent, the pounds exist and appear somewhere as a deposit. Yet in the case under consideration the loans to the British Government alone are of the order of £8,000M. whereas the total amount of money is less than £2,000M., the latter figure being probably not more than 10 per cent. of the total of sterling loans outstanding.

As the pounds do not exist, it appears inevitable that the debts have somehow been incurred for goods sold upon credit, and although the actual manufacturers of the goods may not be out of pocket, the debt has been transferred to those who are prepared to invest in these securities.

Now, in a previous description of the circulation of money, I hoped it would be easier to understand if

I explained the circuit while assuming that the capital money employed was the absolute property of the manufacturers and shopkeepers concerned. In actual fact this can very seldom be so, as the whole transaction will usually be financed on overdrafts or loans. Indeed, as all money, not created by banks for the purchase of property is created by banks for the issue of loans, so the bulk of money is directly or indirectly always owing to banks, who firmly consider it as their property, and only grudgingly and temporarily place it in the hands of the public.

Considering the matter in this light, we can now look again at the circuits of money described in Chapter V. It may be recollected that there might be assumed to be a circuit of capital money used to make payments to other concerns. This circuit can be summarised as Bank—(Factory—Factory)—Bank, the factories being bracketed, as, in fact, these only have the privilege of writing and forwarding cheques. The money remains the whole time as an entry in the banks' ledgers.

The second circuit which was dealt with at greater length, was the circuit which forms the incomes of the community. It was Bank—Factory—"Pocket"—Shop—Bank.

Considered now in the light of loan finance, the first circuit of payments to other manufacturers becomes as follows:

A bank lends to a manufacturer, creating money for the purpose. This manufacturer pays other manufacturers for goods supplied and the suppliers repay earlier loans to the bank. As repayment of a

loan destroys money, that is the end of the amount created, and a stage of manufacture has been financed without leaving any money in existence.

In this way the goods can be passed from producer to producer, till finally the retail stage is reached and the last loan cycle is as follows: A bank lends to a shop. The shop pays a manufacturer, and the manufacturer repays his bank.

If the manufacturer and the shopkeeper were using their own money there would now be a deposit standing to the credit of one of them, but if the bank finances the transaction the position on completion of production is, that the shopkeeper owes the bank money and the manufacturer is square. There are no deposits standing to the credit of producers.

In addition to borrowing from banks to pay other producers for materials, manufacturers will also borrow to finance the other cycle of money, and pay wages to their employees. So, when the goods arrive in the shops, representing a debt from the shopkeeper to his bank, there will be in the hands of consumers a certain amount of money.

If the public now use their incomes to buy goods from the shopkeeper, he can use this money to repay the bank, either wholly or in part; the deposits of consumers are reduced to nil, and there are now no deposits anywhere. In this way the whole trade is financed, and there is no money left in existence.

Now if, as many people suppose, the whole of money distributed to consumers is sufficient to extinguish the prices in the shops, then the system is an excellent one, as when goods are sold for final



consumption, no more money is required in connection with them.\* Unfortunately, however, all the money distributed by manufacturers does not go to consumers, much of it goes to other manufacturers, who use it to repay earlier loans, with the result that the price of goods in the shops may be much higher than the deposits of consumers, and if the goods are to be sold they must then be sold with money from some other source. Or in the words of Major Douglas, "Since A will not purchase A plus B, a proportion of the product at least equivalent to B must be distributed by a form of purchasing power which has not been comprised in the description grouped under A."

This form of purchasing power is supplied by the money created by banks for the purchase of the various bonds and debts previously described. If the public bodies who are so fortunate as to be granted these long-dated loans were merely to buy the surplus consumption goods which our own people are unable to buy, they would then consume the goods, and industry could exist without the necessity for expansion which we discussed in Chapter VI. Our people would then be allowed a certain standard of living on condition of producing a large quantity of goods which the banks could export or "lend" to public bodies at home.

But this, of course, is not the exact case. Although the total of loans is constantly increasing, individual loans must from time to time be repaid, arrangements must be made for some sort of direct

\* Neglecting second hand sales.

or indirect sinking fund, and in any case the interest must be collected. The public bodies who have been lent money cannot then buy consumption goods, as only with goods of a capital nature can the pounds required for interest be obtained by selling in this country the product of exported machines.

The way in which long-dated loans enable consumable goods to be sold is by the incomes distributed for work in manufacturing new production goods, enabling the overhead costs of consumption goods to be met. Most of the cost of these production goods will then be paid with new fixed loan money, and in this way the manufacturers of production goods are enabled to repay their overdrafts.

But there is here a cycle of money which we have not yet considered. The banks create money, and with it buy debentures from private firms, Corporation Stocks from the bankers of corporations, and Foreign Bonds from the bankers of foreign countries, all the transactions being amicably carried out in some city office. The new money is then credited to the borrowers, and is used to buy production goods of various sorts, and the manufacturers of these can then repay their loans to the banks, the cycle being: Bank — Public Body — Production Manufacturer — Bank. Again, the production goods are delivered without any deposit remaining in existence.

I trust it is now clearer how, after a century of finance on these lines, there is in existence a vast compilation of debts, and only a comparatively small amount of money. The latter in fact only represents the amount which is in "pocket" upon one of the

various cycles and the private capital actually owned by individuals or firms.

Although they have been delivered, it must be remembered that the price of these production goods is not really off the market, as principal and interest on the loan must be found. As these are due in pounds, the goods to earn them must be sold in Britain, and the money to buy these products can only be made available by yet further production loans to buy yet further production goods, and so on. We are back to the fact that even with the assistance of long-dated loans, industry can only exist if it is expanding, and an ever-increasing total of loans is essential if the present system is to be preserved.

Now this exposition of loan finance may seem a little involved, yet, as far as I can ascertain, it is in accordance with the scientific principle of always adopting the simplest explanation which accounts for the facts. At any rate, I hope that it will not be supposed that the involved theory of loan finance, taken together with the involved theory of purchasing power, will make the whole matter too abstruse for analysis. In actual fact the two theorems confirm each other.

We have thus actually three separate proofs of the deficiency of purchasing power inherent in an industry of constant extent under the present price system. First, it appears undoubtedly to be the case that not only the poor but also the comparatively rich all desire something which industry would gladly produce could they be assured that the market would be available. This state of affairs undoubtedly shows that the

market is not created during the manufacture of the goods, and that there is not sufficient purchasing power distributed.

Secondly, we have the debt situation just discussed. The debts do not represent money lent from one investor to another, as in that case the money would exist. The debts, then, represent goods sold but not yet paid for, and, if anything up to £20,000M. worth of goods have still to be paid for, it appears fairly clear that the money distributed during manufacture is insufficient to meet the price!

Lastly, there are the theoretical proofs, which are chiefly of value to refute theoretical critics, who for some incomprehensible reason will go in face of every fact of the situation and attempt to argue that there is sufficient purchasing power to buy everything. We can, however, leave these critics to confound each other, and with three clear proofs before us proceed with greater confidence to a more complete analysis of the whole working of money in industry.

We have seen that all money starts in a bank and generally leaves it on loan; and we have investigated no less than three cycles of money on its journey to and from the bank, or, speaking more accurately, how money moves round the banks' ledgers. The first circuit we saw when looking at the deficiency of purchasing power due to the circulation of money. This circuit of money was from the account of one organisation transferred to that of another, so as to make the "B" payments from factory to factory. I summarised the circuit as Bank—Factory—Factory—Bank.

The second circuit was described at length. It represents the path of the incomes of the community as represented by the "A" costs. It was summarised as Bank—Factory—"Pocket"—Shop—Bank.

Then we found a further circuit in the permanent loans which are made to public bodies at home and abroad, who are thus enabled to buy the products of our factories for which the incomes of our own community are insufficient. But this circuit comes after the goods have been completed and is the circuit in which payment for them is made. Prior to this there will be two other cycles similar to those already discussed.

If we consider separately the factories who are manufacturing the goods which represent an expansion of industry as distinct from the replacement of existing goods, these will be largely employed in the manufacture of production goods which will be bought with the money from long dated loans. They will make A and B payments similar to the factories which we may take to be employed upon goods for home consumption, or goods for exchange with foreign products.

The third circuit in which money can circulate will then be very similar to the first. It may be summarised as Bank—New Production Factory—Other Factory—Bank. And the fourth circuit will be Bank—New Production Factory—Pocket—Shop—Bank. It is the pocket period here which enables the Class II costs of consumption goods to be met. Finally there will be a fifth circuit, upon which we have already touched, which enables the manufacturers

of the new production goods to recover their costs and continue production. This circuit will be Bank—Long-dated borrower—Production Manufacturer—Bank.

I believe that these circuits, taken together, will account for all the outstanding facts, and may be taken as an outline of the whole working of money in industry.

I am now attempting to show the position diagrammatically (*see page 119*).

*Explanation of the diagram.*

The diagram is intended to represent the circulation of money round the five circuits explained in the text. The oblong blocks represent the financial aspect of the various branches of industry relevant to these circulations, and are labelled accordingly. The size of the blocks is not intended to represent any statistics.

Above all is the banking system which will store all money required for the five circuits and supply the new money necessary for expansion.

The left-hand oblong immediately under the banks represents all established factories, farms, etc., which are working on the replacement of products now being sold in the home consumption market, or upon products which have been exchanged for things more conveniently produced abroad. The block is intended to include all necessary replacements of plant required for this part of industry but no expansion. The block is divided into two to represent the two types of payment made by industry. The left-hand half being

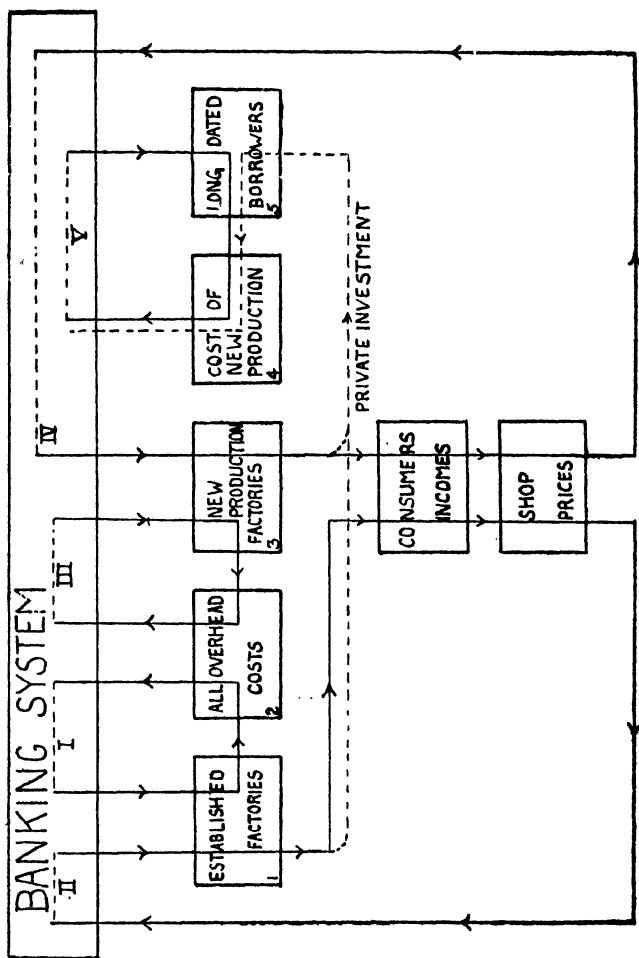
the "A" payments or income payments made to individuals, while the right-hand half represents payments made to institutions outside this group of industries. E.g., instalments paid to finance companies, sinking funds, repayment of loans, and depreciation where this is distinct from maintainance. I have called these overhead costs. The two payments from this block are the start of the first and second circuits discussed in the text.

The second oblong represents the total of all such overhead costs. Both the overhead costs from the existing factories in block one, and also from the new production factories represented by block three.

This third block represents an expansion of industry. All new factories, plant, etc., built in this country and all goods produced by them that have as yet no equivalent price in the home market. These factories, etc., make payments similar to those of the older factories and these payments are the start of the third and fourth circuits discussed.

The fourth oblong represents the price of this new production. The products will largely be capital goods, machinery, etc., and although their prices have not yet reached the consumption market; so that the public are not yet being asked to pay for them; nevertheless the manufacturers wish to be paid so as to be able to carry on business. This payment is made with the money subscribed for long dated loans.

The long dated borrowers are shown in the fifth oblong, and the money paid by them is on the fifth circuit discussed. To save complicating the diagram





I have shown these loans as being entirely subscribed with new money. As the loans are largely held by banks this will not involve serious error, but those interested in private investment can follow the dotted line from: Bank—Private incomes—Long dated borrowers— New production costs—Banks.

Underneath these five oblongs is shown a block representing the total of consumers' incomes, being the total of the income payments of the old factories, together with the incomes from the new factories, etc.

Under this, again, is shown a block representing shop prices. As a general rule these will be approximately equal to the total incomes available, as shopkeepers and manufacturers will adjust their prices to fit, getting a profit or a loss according to the rate of expansion of industry.

The arrowed lines represent the path of money during circulation, and five circuits are shown corresponding to those explained in the text. The circuits are shown dotted in the bank, as, of course, the units of money are there indistinguishable.

For the perfect working of industry the same amount of money should pass in the same time in each of the five circuits—*e.g.*, if one circuit takes twice as long as another, then twice the amount of money should be involved. Actually such perfect working will seldom be the case, and the financial system is sufficiently flexible to allow of considerable disequilibrium. The fifth circuit, and consequently the fourth, might in times of depression appear years out of place, causing a threat of breakdown in the entire system. .

## CHAPTER IX.

### *Historical Aspect.*

This system, as outlined in the previous Chapter, gives a rough idea of how industry has been financed up till the present time, and without yet discussing the merits or demerits of such a system, it is interesting to glance at the historical aspect of the matter with a view to discovering if the same system is likely to go on working in the future:

Regarding the supply of money necessary to finance these circuits, we have previously suggested that the money supply should continually increase to finance an expanding industry. It might be supposed that with the system just outlined, an almost unlimited industry could be financed with very little money, and, in fact, a turnover of £40,000 M. per annum is financed on less than £2,000 M., which shows that the rate of circulation is very high and cannot be greatly increased.

But even if everything always worked as neatly as is shown in the diagram, each of the circuits shown must take an appreciable time, and consequently there must always be money in circulation. As the velocity of this cannot be greatly increased, the expansion of industry necessitates that the amount of money required to finance each circuit becomes greater, and the total amount of money must increase at the same

rate as industry expands, which must be a very great rate if the system is to continue to work much longer.

I have attempted to show that industry does not work as many people suppose, by manufacturers distributing sufficient money to enable consumers to buy the products of the manufacturer. I hope it has been shown that this can only be so if industry is expanding at an ever increasing rate, the rate depending upon the amount of average overhead costs compared to wage costs.

It will be realised that in mediæval times, when everything was made by hand, the proportion of wages to total costs would be very much higher than it is to-day, and the expansion of industry necessary to ensure everything being sold was far less. Consequently the normal increase of population and the discovery of new luxuries may generally have been sufficient to provide the necessary expansion, the chief problem being the provision of an ever increasing supply of money to ensure that the expansion was properly financed.

Prior to about 1819 the money supply in Britain was made to depend upon a form of bimetallism, and an interesting volume could be worked up showing the continual struggle to make the output of the mines sufficient to cope with the increasing rate of expansion rendered necessary as early labour-saving devices were introduced. Such a history would show that when the output of the mines tended to fall behind and expansion became less rapid, industry would languish, and times of depression and hardship set in. On the other hand, when large new industries of

precious metal were made, industry would expand rapidly, standards of living would increase, and if the find were of sufficient magnitude, inflatory symptoms might even be present.

We have not time here to go wholly into the early history of England from this point of view. It will be sufficient to call attention to the expansion following the discovery of the mines of Mexico and Peru by the Spaniards in the sixteenth century, and to glance at how Europe was rescued from the hungry 'forties by the timely discovery of gold in Australia and California.

But prior to this latter discovery came the invention of steam power and the beginning of the industrial revolution. With this, wage costs began to fall heavily in proportion to total costs, and the necessary rate of expansion increased. For a time industry was threatened with collapse, and it was a fortunate coincidence that just when it was most needed, the system of export by means of extensive foreign loans also began to expand. Loans were floated chiefly, as we have seen, with new money created for that purpose, and the money was lent both at home and abroad, so that British goods could be sold and exported in return for paper indebtedness.

Now, in 1844 the monopoly of the money supply was finally made over to the Bank of England, who bound themselves, in accordance with the curious superstition then current, to exchange any money created by them for a fixed weight of the metal gold, if such exchange were demanded by the holder of the money. This demand was very seldom made, and

the bank generally considered it safe to issue up to ten times the legal value of the gold. Nevertheless, this promise set a limit to the supply of money, and consequently a limit to the rate at which industry could expand. The rate of expansion necessary to ensure prosperity could still only be obtained in times following discoveries of precious metal, and the history of the nineteenth century will show that this was in fact the case.

It must not be supposed from this that the financial methods employed during the nineteenth century and up till the time of the first world war necessarily performed the purpose of industry in ensuring the distribution to the people of their products. We have seen that many of these products were virtually given away abroad, and it is unnecessary to repeat here an account of the evil conditions of nineteenth century industrialism to see the futility of manufacturing valuable goods for the foreigner when many of our own people were in dire poverty, and many of our industrialists in constant fear of bankruptcy. It is also outside the scope of this work to dwell upon the horrors of the frequent depressions which occurred when the system got out of step and the rate of money supply became less than the necessary rate of expansion. There is a vast literature of both history and fiction which ably depicts the conditions.

The financial history of the war of 1914-1918 is of great interest in demonstrating the prosperity which follows any expansion of industry. Up till the outbreak of war those who controlled the money system had made, as an excuse to provide an adequate

supply, the existence of a gold standard. This is merely a promise on the part of the Bank of England to buy and sell gold at fixed prices. The value of the gold held by the bank was very small compared with the total amount of money available to buy it, so when a fraction of the people attempted to exercise their right to buy gold the bank had none to sell and was technically bankrupt.

The banks then closed their doors and ran to the Government for assistance. The state, which had been bullied by the bank for a century, had now to come to the bank's assistance and settled the simple problem in twenty-four hours. Under the authority of the Treasury, paper notes were issued and the people were asked to accept these instead of gold. The validity of the notes was never questioned and an entirely new money system came into being over a week-end.

The war then became the greatest industrial expansion of all time. Everyone was put to productive work of some kind, and the question of the sale of the products did not arise. They were given away free to the enemy. As to finance, money was created as needed, although the state allowed the bankers to create the money and call it debt, instead of following up their success with the treasury notes and making the cheque money as well.

It is possible that the government of that day lacked the power to do this. It was one thing to help the banks in a sudden emergency, but another to assume the power of money creation, which would have been opposed by the whole "Money Power" of

the world. The British government would have had to fight these as well as the Central powers, and in a non self-supporting island might easily have been unsuccessful in both contests.

Actually the War was financed by a series of loans just as the industrial expansion of the nineteenth century was financed, and the loans were raised in the same way, though, owing to the rate of expansion being larger, less camouflage could be employed to give the impression that the money was put up by the public. Anyone with a hammer and a shed was granted unlimited overdrafts to finance the production of war material and the banks were willing to take up almost unlimited amounts of "War Loans." The latter enabled the former overdrafts to be paid so the money in circulation was not increased to the extent of the loans, although large increases did take place.

This production without the need for sales caused great prosperity among the people. High wages were paid to everyone, and fortunes were made in industry. The word "profiteer" dates from that time.

For some time after the outbreak of peace the expansion continued. Indeed, the years 1919 and 1920 are almost unique in financial history as during part of that time the incomes of the people actually appeared sufficient to pay the price of such finished goods as were for sale. The reason for this was not far to seek. During the war production had been chiefly confined to war material and there was a real shortage of the sort of goods likely to be required by returning heroes. At the same time vast fortunes had been made in industry and high wages were being

paid, while purchasing power was distributed literally in lumps in the form of war gratuities; many of which were considered as income and spent as such.

A phenomenal rise in prices, which may or may not have been justified, was insufficient to prevent the supply of purchasing power being in excess of the goods available, and it was necessary to be on a waiting list before one could purchase numerous ordinary requirements.

But in 1920 a new banking policy set in. Loans were ruthlessly recalled and just at the time when methods of mass production, learnt on war material, would have been able to satisfy the demand for goods, the money necessary to affect the sale was re-collected to the banks and destroyed. In 1921 and 1922 there was carefully propagated talk of overproduction.

The great deflation, which began in 1920 and culminated with a return to the Gold Standard in 1925, was an attempt on the part of our financial rulers to revert to exactly the same conditions as ruled prior to 1914. The system of foreign loans began again and central Europe was re-constructed by these methods, while America was frequently denounced for not playing the game, in that she asked for the gold which had been promised to her to be sent in gold, instead of allowing it to be funded into long dated debts, and then issuing further loans to enable the interest on these to be paid.

On the theory that industry can only work if it is expanding at a rate dependent upon overhead costs, it will appear that the difficulty of a reversion to pre-war system would be almost insurmountable as the



efficient methods of machine production learnt during and after the War have raised the proportion of overheads to wage cost to 125 per cent., and the amount of new loans to be issued each year is probably far too large for a money supply based on any form of Gold Standard. At any rate, the world gradually drifted into the "crisis" of 1931.

The events since that time are so recent that it may be too early to attempt to unravel their real significance, yet they form an excellent example of how industry can correct some of the defects in the financial system of living on capital in time of depression. When the rate of expansion of industry falls below that which is necessary to ensure everything being sold, there is at once apparent a surplus of goods which cannot find buyers, and there is talk of overproduction. This talk was very usual in City circles from 1929 till 1932, but by that time numerous writers had pointed out how ridiculous was such an idea in face of the extreme poverty prevalent among all classes at that time: consequently the talk of overproduction was stopped. Nevertheless, during those years and afterwards, although production was all the time becoming easier, the sale of goods became more and more difficult. Profits were first cut, then reduced to nothing and finally so as to obtain something from the wreck, goods had to be sold under cost.

This selling at a loss clearly increases the purchasing power of those with fixed incomes, but only at the expense of producers who will definitely be unable to allow this to become the normal condition of industry unless their loss is made up to them in

some way. Yet from a purely financial point of view, selling at a loss can be carried on indefinitely if the banks are prepared to finance the difference. Any balance standing to the credit of producers will first be reduced to nothing and then an overdraft will begin to grow. This may so upset the peace of mind of old-fashioned producers that they may be driven to suicide, but if the producer is not the worrying sort or is merely a manager who draws a salary anyway, then the additions to an overdraft being merely a matter of book entry can be compiled indefinitely, just as the total of fixed long dated loans is indefinitely increased.

In practice, of course, the banks are not prepared to allow overdrafts to increase indefinitely, and only grant them to trade over bad times until long dated loans can be floated and industry set going again on normal lines.

Before resorting to an overdraft, many conservative firms will first attempt to fall back upon the reserves which were collected in good times; these reserves consist of negotiable securities, which must be sold if money is to be obtained, but in the event of any wide-spread depression, all firms would be desirous of selling their reserves at the same time, and in the absence of buyers the price offered would be nil.

If, however, the banks are prepared to co-operate with industry they will create the necessary money and buy the stocks which are offered by firms desirous of liquidating their reserves. The banks may not consider themselves justified in doing this if they lack "confidence" in the government in power, and in the

absence of support from the banks the price of stocks will fall. Consequently the value of £s in the international market will be less and the £ will be quoted as equal to lower amounts of other currencies. The people are then told that "All our food comes from abroad, and if the £ goes down we will not be able to buy it." In this way the government was changed in 1931, confidence was restored, and the banks came into the market as buyers. In the case in point they have raised the price of what is now the  $3\frac{1}{2}$  per cent. war loan from 90 at one time in 1931 to 109 in 1934, and that in spite of the interest being reduced from 5 per cent. to  $3\frac{1}{2}$  per cent. in the meantime.

This raising the price of gilt edged stocks inaugurates a cheap money period, *i.e.*, public bodies can secure long dated loans at low rates of interest and if they can be persuaded to borrow in this way industry can be made to revive along the old lines. Many such loans have undoubtedly been floated in the last few years and, during that time, the newspapers have confidently announced that there is a revival in industry, though I have not yet been able to find a shopkeeper who whole-heartedly agrees with them.

## CHAPTER X.

### *The Future of Industry.*

We now come to the chief object of this volume in discussing whether, or not, it is possible to continue the system which has worked with only indifferent success for the last century. The ethical problem of whether the people are happier under one system or another, or whether bankers are necessarily competent to rule, is, perhaps, a little outside my province, as, in the eyes of a scientist, a system which works is automatically right; the extent of its rightness being only measured by its percentage efficiency.

Were it desired to argue from this premise it would be easy to show that the percentage efficiency of the present financial system is absurdly low. When an engineer is shown a new machine his first question is, "What is it for?" and his next is, "Does it do it?" or, possibly, he takes the latter for granted and asks how the units of work obtained from the machine compare with those originally put into it in the form of fuel.

Approaching the financial system on these lines we have agreed that the object of this system is to enable the population of a given economic area to obtain the full benefit of the goods and services that they can produce. In view of this a system which compels the export of a large proportion of goods in

return for permanent paper indebtedness is self-condemned.

Even if the export of British capital goods is considered as purely geographical; even supposing that British goods had been sold only by means of loans to British institutions; is it an efficient system whereby the means to distribute our existing final products can only be obtained at the whim of certain institutions, who insist on the newly created money being issued as a loan, and consequently that it must be used for the construction of yet further productive machinery which activity may be unnecessary for the comfort of humanity, and which may compete unfairly with already existing plant?

Even less efficient does the system appear when some of the other conditions attached thereto are considered. Take for example, the idea that the total quantity of money must be a multiple of the legal value of the gold which can be mined. Consequently upon this the rate of expansion must depend upon geographical discovery and upon the efficiency of mining engineering, not, be it noted, upon the needs of man or upon the rate of expansion necessary to preserve the system. On this count alone the system is self-destructive and in no sense "right."

In addition to this, there is the restriction that the country town or other organisation which is granted the loan must be creditworthy. How to achieve this blissful state is beyond me to explain, as many post-war loans seem to have been made in defiance of this condition, and, apparently, it is the object of our rulers to export goods at any cost in

preference to arranging for our own people to consume them. Nevertheless, there are some simple rules for the creditworthy. The interest on previous loans must have been punctually paid, the amount of the loan outstanding should not appear to be too large an amount per head of population, and the borrowing institutions must also be in a position to sell their products in competition with others so as to be able to pay interest on the loan.

What countries to-day fulfill these conditions? Is not default the order of the day from all over the world? Great Britain, herself, usually the very fount of honest finance, has repudiated her debt to the United States. The world is saturated with loans, and, even were further loans to be offered, it is quite possible that they would not be accepted.

It must also be realised that during the nineteenth century there was really only one creditor nation, Great Britain. The whole world was glad to be her debtor and into their territory Britain could expand her industry by issuing two new loans for every one that was repaid.

Early in this century, however, several other nations began to question this position and showed the desire to expand themselves, and to compete with Britain for industrial expansion. Many people are convinced that the fundamental cause of the first world war was the desire of Germany to share Britain's position in the world markets, and a phrase may be recollected about "A place in the sun."

Under post-war conditions, it must be realised that there are several great nations who have become

industrialised and desire to share with Britain the right to export goods in return for paper indebtedness. These nations are generally prepared to compel their workers to accept a lower standard of living so as to compete with us and will take greater risks with the financial system which they operate, so that the possibility of Britain being able to compete with them in the world market is unlikely.

It is a curious ambition, when real things are considered, this struggle to export one's property, but it is essential to any nation who attempts to work the present financial system, and if that system is preserved, it is inevitable that this competition will lead to war between some or all these nations. It must be remembered that the system is essentially one of book-keeping and it can be fairly easily altered. A course of action, which it need hardly be pointed out, is infinitely to be preferred to the disaster of a further great war.

In conclusion, it may be said that it is physically impossible to preserve the present system, even by the means of war which is invariably made an excuse to break all the tenets of sound finance. A system which depends upon expansion must ultimately be limited by the bounds of geography and the limits of the world are rapidly being reached.

**The present system of accounting prices can only be successful if industry is expanding at a rate dependent upon the ratio of total costs to wage costs. The increasing use of machinery together with the limited size of the planet make such a rate of expansion impossible under modern conditions :**

even with the aid of war.

The remedy is to devise a more accurate method of accounting prices which will ensure that the community have sufficient money to buy the entire production of industry without the necessity of industry expanding. A price system is only a matter of figures and these can be adjusted with comparative ease.



## CHAPTER XI.

### *A Stable System.*

Having attempted to make clear, 1. The object of industry, 2. Why it does not attain it, 3. The subterfuges which have hitherto been employed to keep the organisation going and 4. Why that subterfuge is no longer effective, it is now necessary to outline any suggestion which may help to solve the difficulty.

Before doing this I would like to point out that it is definitely impolitic for those who criticise the present financial system to submit plans for reform. Not because there is anything wrong with the plans, but because readers will take the financial system for granted and on picking up the book will immediately turn to the proposed remedies. Being entirely ignorant of the working of the present system, and consequently oblivious of any inherent flaws which it is desirable to correct, readers are then surprised and irritated when suggestions for reform appear to them incomprehensible.

If the cause of the collapse of industry were known by the Press and politicians of the world, the propounding of a plan of reform would be the only excuse for a thesis on the problem, but, with a few honourable exceptions, neither of the above appear to have any inkling of the real problems and are apt to concentrate on mere symptoms like unemployment.

This is in fact, a symptom of health and not of disease in the industrial system, as clearly an industrial system, that can produce all that is required with half the available labour, is more efficient than one which requires many more hands.

If, then, you have been unable to read and understand the first parts of this book, and have turned to Chapter XI to see what is proposed, I must disclaim responsibility if you are unable to understand the remedying principles, and must caution you against becoming a menace to your country, and to civilisation by going about saying that the Douglas plan is no good, and could not possibly work.

I trust, however, that you will find it worth your while to master the not very difficult outlines of the present financial system, as you will then discover why your standard of living is tending to decline, or at any rate to fall behind the ever increasing productive power of industry. You will also learn why yourself, your sons and your daughters will almost certainly be involved in another world war.

In this preamble to a scheme of reform, I have tried as far as possible to avoid the use of the world plan. Major C. H. Douglas, whose ideas I am attempting to expound, has now been the centre of financial discussion for a matter of fifteen years and I once heard him asked some question regarding his "plan." He replied, "I have no plan." This is because the word plan would seem to employ a more or less cut and dried scheme suitable for embodiment in an Act of Parliament.

The drawing up of such a plan will be a simple

matter when the time comes, but it has been decided that at present it is preferable only to outline the principles to be followed. After some years of very careful investigation, I have no hesitation in saying that the principles of Major C. H. Douglas are those which it is desirable to follow in correcting the flaws in the present financial system, and it is his ideas which I am now attempting to explain.

In case you should have disregarded the request to read the first part of the book first, and in any case for the refreshment of memories, may I now sum up the conclusions which I have attempted to prove in the foregoing sections.

I hope it has been made clear in the first three sections of this book that under the present methods of distributing incomes and of accounting prices the products of industry can only be sold if the bounds of industry are continually increasing at a great rate. In olden times, where the necessary rate of expansion was much smaller, this was, perhaps, a reasonable system, but it is not so under modern conditions, when the necessary rate of expansion has been rendered enormous by the methods of mass production, and when several nations are competing for room to expand. Considering the limited size of the planet, sufficient expansion is now impossible and a clash between the nations, which will involve another war, becomes a certainty if the present system is continued for a few more years.

The problem then before us is urgent but fortunately it is itself not difficult to discern. It is merely the difficulty of devising a system which will

enable the population of the planet, the country, or any credit area, to purchase the products which they produce without the necessity for continual expansion. To solve this problem may not at first sight appear so easy as to state it, yet the difficulties of understanding an essentially simple solution are chiefly psychological and founded on deeply ingrained subconscious ideas, some of which are unfortunately quite incorrect.

If it can once be grasped that there is plenty in the world for everybody; and that our money and price system are merely a system of book-keeping designed, yet failing, to bring this abundance to our hands; it follows then that it is only the books which are wrong, and I hope to be able to show how an alteration of the books will enable us all to achieve the material prosperity which is known to exist.

The problem as outlined is then to place in the hands of consumers sufficient purchasing power to allow them to buy the products of industry without the underlying condition that they must at the same time produce an unnecessary quantity of new production goods, whose sale may involve the world in another war.

Consider this problem in the light of the various circuits of money outlined in Chapter VII and the diagram about them. Here we saw the purchasing power necessary to buy finished goods being supplied from two sources. These were, firstly the incomes distributed in connection with the manufacture of all classes of goods which will actually be required by the people, and secondly the incomes paid for work on

new production goods which may not be required by our own or any other people. They are required so little in fact that the nations are preparing to destroy each other so as to prevent their import while their cost has hitherto been met by an ever-increasing total of long dated debts.

It is now proposed that the second source of purchasing power shall be issued without the condition of new production or of paying interest on the amount and without any implication of eventual re-payment. The last circuit of money which at present is:—Bank—Public body—Production manufacturer—Bank, would in future be virtually:—Bank—Consumer—Shop—Bank. Although, for various reasons, the actual circuit is made somewhat differently.

There are, naturally, a good many details to be worked out to enable such a plan to be put into operation, though considerably fewer than those at present required for such an operation, as for example, the collection of income tax. It will have to be decided how far the present banks will be prepared to co-operate in any plan of this sort, and how far it is desirable to allow private interests to issue and re-call the nation's money for their own purposes. At any rate, it seems to me desirable that the state should become the authority responsible for the issue and re-call of money, leaving to the banks the keeping of the ledgers as a record of transfers of money between individuals. This is the proper function of banks, and was their position until comparatively recently. A charge was then made for the service of looking after money, as opposed to the present system

of allowing interest on deposit accounts.

The State would then become the authority for lending money to private firms, as opposed to its present position of being the largest of debtors.

For the purpose of financing consumption it is therefore suggested that a national credit account be opened. Airy phrases are often bandied about concerning the credit of the country, but few people have any realisation of what this really means. It is generally taken as an ability to borrow money, but upon what real things must this ability finally depend? We have touched elsewhere on the question of "creditworthy," which fundamentally means the ability to sell goods so as to pay principal and interest upon the money lent. The sale of the goods will, of course, depend upon whether when the time arrives there is any money in existence available to buy them. But in considering real things as opposed to ledgers, the real credit is the goods and services produced. Hence Major Douglas' definition:—The real credit of a country is the ability to deliver goods and services as, when and where required.

Now in regard to opening a national credit account, this will merely be a figure either with or without a £ in front of it, and may conveniently be taken to represent a credit account held at the bank on behalf of the nation; just as the present ways and means account generally represents an overdraft at The Bank of England.

I must now hasten to assure tax payers that the amount of the National Credit Account is not to be subscribed by them. The account will first be

credited with an amount representing an estimate of the real credit of the country, which amount will be adjusted from time to time in accordance with the true prosperity. This alteration of the ledgers may conveniently be carried out by the present Bank of England, but it is not intended that the amount debited or credited should, as at present, be under their control. These amounts will be decided from statistics in a manner to be described shortly, and the bank instructed to make the necessary entries.

This really amounts to the right of issuing money reverting to the Crown, which only comparatively recently made over the monopoly to private interests. This reversion of the most important of sovereign rights does not mean the placing in the hands of politicians the right to create money with which to bribe the electorate. Its object is to put the supply of our national money upon a scientifically ascertained basis which reflects the real wealth of the country.

It has been pointed out that the real credit of the country is the ability to deliver goods and services as, when and where required, and this ability will depend upon the capital resources of the country. So as to arrive at a figure with which to open the National Credit account, it is therefore proposed to obtain from existing sources a valuation of all existing capital assets.

It is sometimes not fully realised that productive machinery of any sort is equally valuable to the community, whether it is in private or public hands, as the only way in which the owner of a plant can obtain a return upon it is by providing goods for the com-

munity. It may still be argued that it is possible in theory to obtain a better return by selling few goods at a high price than many at a lower one, and that the former alternative is of less service to the community. But the present machine age and the system of accounting overhead costs is almost certain to make such a course of action unprofitable in practice as, when the machines have once been installed, it always pays better to work them to the utmost capacity, on the principle of small profits and a large turnover.

The valuation of the National Credit is then to include everything that will in any way contribute to the national wealth, whether it be in private or public hands. Railways, roads, bridges, schools, all productive machinery, and even the adult population as potential producers are essentially national assets. This valuation being adjusted from time to time as the capacity for production increases or decreases, will be an accurate measure of the wealth of the nation for which there is no existing equivalent. The annual budget, whether balanced or otherwise, is merely an account of one commodity, *i.e.*, money whose manufacture is under the direction of one firm, who own the monopoly and in whose interests it is to keep the amount short so as to lend it at higher rates of interest. The accounting of money manufactured on these terms is in no way a reflection of the prosperity or otherwise of the nation, and the balancing or unbalancing of the budget is merely a reflection as to whether the quantity of money has been increased or decreased in the preceding year.

It will be realised that a valuation like that pro-



posed will represent a very large figure and, should it pay a dividend of consumable goods in any way comparable with the return expected from an industrial investment, the total goods income of the whole community should be greatly increased above the present level. So as to bring about such a result the valuation of the National Credit must be made the only basis for the regulation of the amount of money in circulation. The amount should depend upon the above total and not upon the exigencies of the money market or upon the amount of one or more metals which are not even mined in this country!

With the National Credit account opened, we can now revert to the main problem of placing in the hands of consumers sufficient purchasing power (which is not necessarily money) to buy the products of industry. For this to be possible it is fairly clear that consumers should receive money at the same rate as goods are put upon the market, and that money should be re-called through prices at the same rate as goods are used up. If one might strike a balance for any period, on one side of the sheet would be the price of goods made and money collected, while on the other side would be the price of goods consumed and the amount of money distributed. This leaves a total on one side of goods made and not yet consumed, balancing on the other side the money in the hands of the public.

One of the subconscious ideas held by most people is that our methods of accountancy will cause incomes and prices to reflect facts in this way, but the existence of numerous deficiencies of purchasing

power show that there must be a mistake somewhere. Without going into all that again, we have seen that in any period of time finished goods will be put upon the market, for which incomes paid during the same time will be insufficient to pay. This is principally due to demands being made for depreciation charges in respect to plant, etc., which is still in good order, in fact money is being re-called faster than goods are used up. The trouble then is not that incomes are too low but that prices are too high.

With a view to ascertaining the actual extent of this error it is again necessary to compile statistics and there must be found, for any period, the value of the wealth created and how much has been used up.

The gain in material wealth in any period will consist of all new goods, and all new productive plant made in that time, together with all goods brought into the country (pace the protectionist party) and any important new discoveries of mineral resources. The corresponding diminution will be the opposite of these things, *i.e.*, all goods sold to the public for final consumption, any goods sent abroad, all wear and tear of plant, anything destroyed by fire, shipwreck or other disaster, and any mines or other productive assets which become worked out.

Leaving out any question of money, the real cost of the wealth gained in any period is the value of the wealth destroyed in the same time. The latter in so far as it can be measured in £s is generally less than the former, and, when this is so, we have a genuinely favourable balance of national appreciation. This should be contrasted with the idea of a favourable

balance of trade which is put about by "the City," where it is considered advantageous to send away more than we receive. This fallacy is founded on the idea that the object of trade and industry shall be firstly foreign investment, secondly the giving of employment, and consumption nowhere.

I have attempted to show that this order of precedence must now be abandoned, as it is clearly impossible for all nations to give away more than they receive and, if consumption is to be the future object of industry, it will be necessary to issue money at the rate of national appreciation and to re-call it at the rate of national depreciation. In fact, the output of the nation should be sold for its real cost, which, of course, includes the remuneration of the producer in the wealth which has been personally consumed.

Now if it is desired to sell things at their real cost, it will be realised that to take any finished article and attempt to estimate the wealth used up in its construction would be a complicated matter and quite impractical as a means of putting a price upon every article in a shop. On the other hand a general estimate of the value of all wealth consumed, is by no means outside the bounds of possibility. Indeed, the necessary data could probably be found among existing Board of Trade statistics.

Whatever system of accountancy is employed, it will not affect the relative value of the amounts, provided the same accounting system is employed in both cases. And, if all production is to be sold for all consumption, the cost of any given article as at present accounted, can be multiplied by a fraction

representing  $\frac{\text{all consumption}}{\text{all production}}$  and the resulting figure will give the price on a general average which the public should be asked to pay for the article. This will represent the true cost of production, but it will probably be far below the cost as at present accounted; and, as we propose to follow present costing methods, it remains to devise a scheme whereby goods can be sold under their apparent financial cost without causing a loss to the producer.

Suppose for the sake of example, that the fraction  $\frac{\text{all consumption}}{\text{all production}}$  were to come to 75 per cent. Retailers would then, under the scheme, be enabled to sell to the public subject to a Discount Factor of 25 per cent., or in other words at 75 per cent. of cost plus profit. Having collected from the public the 75 per cent. which they possess, the retailers would be re-imbursed from the National Credit Account with the remaining 25 per cent. of their price, and the National Credit Account will be written down accordingly.

It might be supposed then that the National Credit Account would, in this way, be progressively reduced, but this is by no means necessarily so. The amount of the price discount factor will, of necessity, be calculated from statistics compiled in a period prior to that in which the factor is applied. Suppose the factor be calculated for a first period and operate during a second. At the end of the second period retailers are paid the amount of the discount on their sales and the National Credit Account is debited accordingly, but at the same time the account is credited with any capital development which has

taken place during the period, and, if there has been any expansion of industry during the second period, the amount credited will be greater than the amount paid to retailers.

It should also be noted that this method of issuing new purchasing power has advantages over the idea of merely issuing new money directly to consumers. In the latter case there is no check on the profiteering of producers usually described as "inflation," but, under a sales assistance scheme as outlined, the National Credit Authorities are in a position to withdraw assistance from any producer who abuses the scheme. This withdrawal would place him in the position of having to sell at prices 25 per cent. higher than those of his competitors.

Actually, in any practical application of this plan, there would be a definite contract between producers and the credit authorities, wherein the retailer undertook to lay his books open to inspection and to limit himself to a fair profit in accordance with the nature of his business. In return for this he should get the benefit of the sales assistance scheme and increase his turnover accordingly. Any producer would be at liberty to refuse the offer, but it is difficult to see how it could profit him to do so as it would involve selling at prices 25 per cent. higher than the prices of those who accepted.

At first sight this may appear a most revolutionary proposition, but as previously stated, the idea is not in essentials materially different from the methods employed for distributing money during the last century.

In those days money was collected from the people faster than the rate of national depreciation and the difference was made up with new money created by the banks. This latter was distributed by means of new fixed loans frequently made to foreign countries, and the total of these, it must be realised, was always increasing, so that the increased purchasing power was really a gift to the world. The proposed new system is in that respect the same in that the new money is issued, but it is issued to retailers so as to allow them to sell to the public at the real cost of production as opposed to the apparent financial cost. The accusation of inflation is often brought against this plan but I think only by those who have failed to understand it. I presume these critics would not claim that the financial system employed by the banks for the last hundred years had been unduly inflationary, and as far as the issue of money is concerned, the plan here proposed can be shown to be similar to that system.

There is, however, another monetary reform which we consider essential, and which I will now try and outline.

## CHAPTER XII.

### *Economic Democracy.*

Just as a money system suitable to an age of scarcity is harmful to an age of abundance, so is the philosophy which has grown up around the system. As previously stated, science and finance are not primarily concerned with philosophy, yet any plan which confines itself to a mere balance of payments and which leaves out of consideration the welfare of the people is bound to lead to trouble sooner or later.

For this reason it must be realised that in a machine age, which has rendered the abundance possible, the full services of the population will not be required for the purpose of production. We have seen how it is proposed to reduce prices so as to enable the money distributed during production to buy the product when finished, so that the consumer can buy what he has made in his alternative role of producer. But whence is the consumer to receive his money if his services are not required for production?

Pure financial theory might say let them starve, or modern political compromise regulate him to the slower starvation of the dole. Imagine then the case of a workman after the inauguration of the price discount factor. If he were employed he would draw his wages and find them buying more and more as the productive capacity of the nation increased. But

suppose, owing to some mechanisation or other reform he were to lose his job, and find himself upon the dole. The present value of the dole, if prices were subject to a 25 per cent. discount factor, might be sufficient to support life, but as the dole is taken from taxation it is extremely probable that its amount would become reduced by the amount of the discount factor. It has actually been said that "Owing to taxation there are insufficient surplus incomes for investment!"

Of course, the power of an irascible employer or peppery foreman to sentence a man to slow starvation makes for a high standard of works' discipline, but such drastic measures are unnecessary in an age of abundance and most out of keeping with modern humanitarian principles, particularly as what is now known as unemployment is bound to increase.

Let us pursue this idea to its ultimate conclusion and consider a machine of such complexity that it can gather fuel for itself and at the same time provide all the wants of humanity. Were such a machine to exist, its owner might be expected to become a rich man, but, in fact, he would be ruined, as under a philosophy of work being the only title to money, no one would receive money for working the machine, so no one would be able to buy its products.

Some economists argue that any improvement in process will automatically reduce costs to the extent of the improvement, and, according to this reasoning our machine would have the effect of reducing prices to nothing so that its products could be given away. This theory cannot, however, hold when mechanical production has become highly developed. The money



used to finance the manufacture of the machine is assumed to have been lent by someone, who will in due course, expect the money back. This can only be recovered through a price being put upon the products of the machine. The only money in existence which could be taken to pay this price is the money distributed during the manufacture of the machine, but this money will have been spent and become capital as it was distributed and the last will be spent within a few weeks of the machine's completion. After this nothing is available, so if the products of the machine are to be sold money must be distributed on some other pretext than that of work.

It is probably a matter for congratulation that we have not yet arrived at such a stage of mechanical development as is suggested here, but the fact of overheads being generally 125 per cent. of wages certainly shows that they have gone more than half-way, and the time has come to take this problem into consideration in the outline of a new money system. It is contended that the idea under which work is the only title to money is obsolete and unworkable under modern conditions, and it is proposed to fall back upon another philosophy which is, actually at present, made the basis of the issue of most of the larger incomes.

It is interesting that those who usually put about the philosophy of work being the only title to money, are actually drawing their incomes, and frequently quite large ones, upon quite a different justification, about which they would become vague and angry if questioned. It is, however, a philosophy which need

not be criticised in an age of abundance, that past abstinence entitles one to draw an income now. In fact, captail investments built up from savings, allow the owner, his heirs and assignees, to draw dividends upon the investment for ever, or until he or his heirs are so unwise as to change the investments unprofitably. It is under this title that most of the well-to-do members of our community draw their incomes.

Keeping this philosophy in mind I would now like to draw attention to our patent laws which are interesting in this connection. When any inventor makes a discovery which he believes to be of value to the community he is granted a patent which allows him the monopoly of his invention for sixteen years. During that time, unless the monopoly is grossly abused, the rest of the community must abstain from the use of the invention or pay the inventor a royalty for the privilege of its use.

In return for granting this monopoly the invention becomes the property of the public at the end of the sixteen years.

Now if a man who abstained from spending his income can save up and buy Government securities, which will pay him an income for ever, why should the community who fairly abstained for sixteen years not draw a dividend upon the invention when it becomes their property? It can be justly argued that the share of any member of the public in any one invention would be negligibly small, but what of the total share in all the inventions and discoveries of the ages. This has been collectively described as the cultural inheritance of the nation, and whose property

is this inheritance? Obviously, it is common property and every member of the community is entitled to draw a dividend upon it, just as wealthy people draw their unearned increment from War Loan and other holdings.

It is, therefore, only just when this cultural inheritance has been valued in the productive assets of the nation, that a direct dividend should be paid upon the amount. If 1 per cent. were paid annually there would be a very large sum which would be divided among every member of the population, and it has been estimated that this might well amount to £300 per annum per family.

It does not require much emphasis to show what would be the advantage of a National Dividend in the way of simplifying the collection and administration of money for the numerous public and private charities which already exist. The often embarrassing methods of collecting money for charity and the red tape of administration would be swept away from the moment of the inauguration of the dividend: as the people would then be in a position to pay for what they required; either at once, or, in any case, on the next payment of the dividend.

It might be said that the people do at present receive a national dividend in kind, in that they are in receipt of the social services and numerous charities and public works for which no charge is made to the poor. Looked at from this angle, the national dividend is, like the discount factor, not really such a revolutionary proposal as at first sight appears.

Only, as at present, the cost of the Social Services

is drawn from other people there is naturally a tendency to keep these services as small as possible, and as at present administered, these are absurdly small in view of the enormous productive capacity of the country.

It should be noted as well, that at present far more than mere desire is necessary before the public can obtain access to most of the Social Services. It is necessary before drawing the dole, or being admitted to many hospitals, to become an expert in the filling up of forms, in the waiting queues, in the satisfying of officials and committees, and in putting up with the inquisition of the means test without smashing something.

For the avoidance of these things alone the idea of the national dividend would hold its place but I hope it has also been shown that the people have a moral and, perhaps, even some sort of legal right to a payment of this kind.

**Therefore :** In consideration of the present condition of the lower paid workers and of the unemployed, and in view of the fact that the numbers of the latter must eventually increase, I submit that, in our money philosophy, we must give less emphasis to the idea of work being the only title to money and more emphasis to the idea that past abstinence by a man or his ancestors entitles him to draw money now.

**This latter philosophy is the justification for by far the larger proportion of the total incomes of the community, and if "fairness" is pertinent to a money mechanism it is most unfair to deny the**

**benefits of this philosophy to those who most require them.**

It only remains to try and answer those who profess to believe that fear of starvation is the only incentive to productive work, and who fear that if this incentive was removed no one would offer themselves for work in our factories and fields.

I shall never forget the surprise and consternation of a well born young lady to whom I innocently suggested that the financial system would work better if everyone were in receipt of an independent income of £1 per week. "Why!" she said, eyes round with horror, "You can live on a pound a week." And before I could explain that that was why I had arbitrarily selected that amount, she interrupted me by saying, "Yes you can! You said things would be cheaper under your scheme!"

It is an extraordinary idea when actual facts are regarded to suppose that people only work from fear of starvation. It was particularly so in the case of my friend, who came from a large family whose elder members had spent their entire lives in the service of the public and would have been deeply insulted at the idea of accepting a penny in payment. She, herself, appeared quite prepared to follow in their footsteps, and was frequently to be seen behind draughty bazaar counters attempting to collect some pittance for charity, and, in the not very becoming uniform of a Girl Guide was prepared to leave her own comfortable home just as dinner was being served, so as to amuse and educate the village children. Yet some idea must have got into her mind that the lower

orders were unlikely to display the same spirit of service, and would be able to sit happily in their chairs or beds for twenty-four hours each day.

Those of us who are old enough to remember the days of the first world war have no illusions as to the ability of all classes to do what they believe to be their duty, and to somewhat brusquely attempt to persuade their neighbours to do likewise. Speaking in the light of real politics, the powers of propaganda of the Press, the poster and the wireless, are sufficient to persuade the people to do or to think anything that the controllers of these agents are paid for. It should not then be difficult to persuade the few hands that are really necessary for modern production to supplement the amount of the national dividend by coming forward for a short working day. Particularly as these agents could stress the point that everyone had an interest in increasing the productive power of the country, as, of course, if nobody worked there would be no production, and consequently no dividend!

The national dividend proposed is to be paid as a direct percentage of the productive power of the country, and the price factor is a direct measure of its increase; were this "real credit" to fall off owing to labour troubles, the effect would be shown in lower dividends and highest costs of living. This seems to give to everyone the long wanted stake in the country, which many believe should be the only title to a share in the Government and it is undoubtedly easier from a political point of view to provide the stake than to restrict the franchise.

The idea that it is only fear of starvation which

causes a willingness to work has been carefully instilled into the subconscious of most of us, and, although we would probably indignantly reject the idea when applied to ourselves, many of us firmly believe that it applies to everyone else, and a certain mental effort may be necessary to enable us to see that this is not true.

We all know the story of the man who refused a job at 21/- a week, saying that his dole was 18/-. He was probably wise. The extra nourishment necessary to enable him to do the job would probably cost him more than 3/-. This is, however, in no way the same situation as the paying of a national dividend, in that, of course, wages are paid in addition to the dividend and if the dividend were 18/- a week (we hope it would be more) wages of 21/- a week in addition would more than double the man's income, and would certainly be sufficient inducement for him to accept the job. Particularly so as with the national dividend behind the man and the price factor before the employer, conditions of labour could be made much more acceptable.

I hope I have been able to show that some form of payment to individuals unconnected with productive work is essential to the working of a price system. I hope I have also shown that the individuals of any nation have, on the philosophy of abstinence, a right to such a payment. Finally, I trust it is clear that the payment of such a dividend will not, in any way, reduce the efficiency of the productive side of industry. Indeed, by improving the conditions of labour it might well increase that efficiency, and a society should soon

evolve which would raise the idea of work from that of an unpleasant toil to an eagerly sought privilege.

To sum up finally the proposed new financial system in the same way as we did the old on page ? I must crave your indulgence of an occasional repetition.

Consider the matter in the light of the circuits outlined on page 116 and the diagram about them. Here we saw the purchasing power necessary to buy finished goods being supplied from two sources. I.e., the incomes paid for work in connection with the manufacture of all classes of goods required for our own people, and incomes distributed for work on new production goods not generally required at home. The cost of the latter being extinguished by an ever-increasing total of long dated debts.

Under Social Credit, the necessary purchasing power is supplied from three sources. The first one being the incomes of the people as before: the second the national dividend; and the third a payment to retailers to enable them to reduce prices. Actually, the amount of the national dividend is included as consumption in the working out of the discount factor so that the three sources of purchasing power exactly enable the whole output of finished goods to be bought.

I have left out administrative details, but it is to be sincerely hoped that the existing banks will co-operate in the working of the scheme, and in fact the National Credit Account would correspond to the present Ways and Means Account at the Bank of England, only the National Credit Account would always be heavily in credit.



The circuits of money similar to those at present existing then become as follows:—

In respect to the discount factor,

Bank—Retailer—Bank.

In the case of the national dividend, it is tentatively proposed that this should be paid through the post office. The circuit then becomes,

Bank—Post Office—Consumer—Shop—Bank.

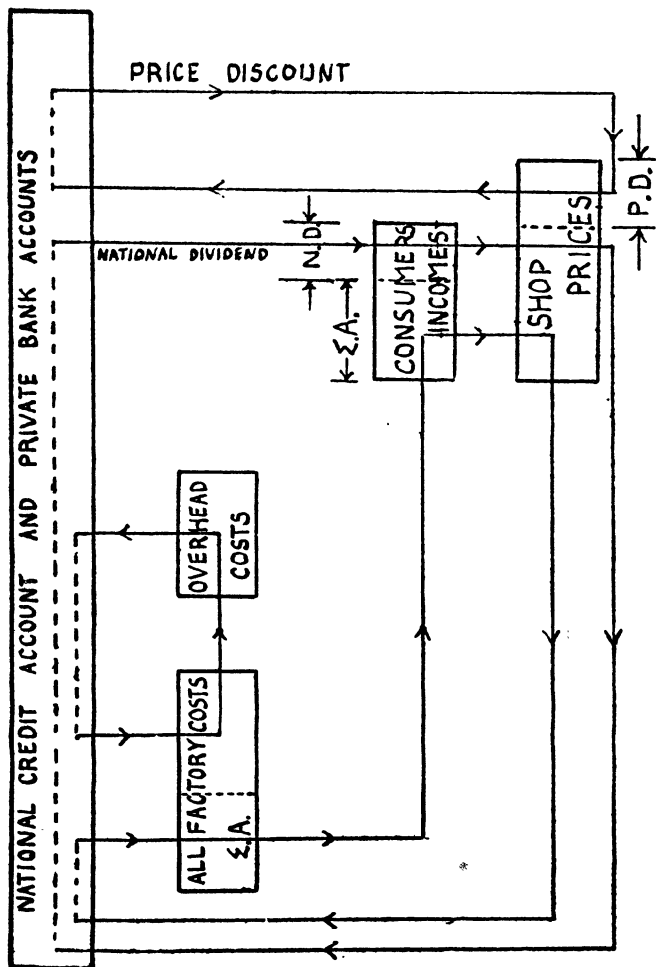
The proposed system is shown diagrammatically and can easily be compared with the picture of the old system shown on page 119.

The same principles have been followed as in that diagram.

The factory on the left is shown larger than previously, as in it are combined what were previously divided into existing factories and new production factories. In this diagram the whole of industry is shown as producing for use, whereas previously much of it was producing for overseas investment, and the goods thus produced only caused competition in the world markets.

Production for use consists of all goods required for home consumption, goods required for exchange with foreign producers, and new capital development regulated by the ingenuity of inventors and the real wants of the community, ascertained from the class of goods which they are actually buying.

As in the present system, industry is shown making income payments to consumers and it also has to pay or allocate overhead costs. The amount of the latter as hitherto had to be extinguished by money distributed for work on new production, and has come



to necessitate an impossible rate of expansion of industry. Under the new conditions these overhead costs would be paid partially by the increase in the national income due to the national dividend. The remainder would be extinguished by the operation of the Price Discount Factor, which may be taken as a subsidy to retailers enabling them to sell at the real cost as distinct from the apparent financial cost. Industry can then take up its natural rate of expansion, or, if society one day decides to lead a more simple life, industry can accommodate itself to the resulting contraction. In any case, the international competition for markets is abolished, the risk of war is removed, and consumers are enabled to distribute the whole output of industry.

## APPENDIX.

### *Foreign Exchange.*

In deference to public opinion on the matter, I am including an appendix on the aspect which the foreign exchange question bears to this problem. Many people believe that our money problems are essentially bound up with those of foreign countries, and it is not surprising that they believe this, as a good deal of money has been spent to persuade them of this fallacy. I am, however, putting the foreign exchange problem as an appendix as in point of fact it has nothing whatever to do with the manner in which we do our book-keeping in this country.

Now, scattered about the world there are numerous monetary units issued by other countries than ourselves. Although there are wide technical differences the manner of creation and destruction of these units will not be essentially different to that employed in the creation and destruction of £s; and, as far as is known at the moment, all nations follow the price system which I have tried to show is unsound, so that all nations are under the necessity of expansion. Though, owing to different industrial methods, the visible rate of expansion may be small.

Now, the monetary units of all these countries are different from one another, just as pieces of wealth are distinct. Francs or dollars must be bought with

£s or sold for £s just as lemons and cheeses are bought and sold, and the prices of francs and dollars may vary as does the price of lemons and cheeses.

When the rate of expansion of industry necessary to avoid a deficiency of purchasing power rose rapidly in the years following the industrial revolution, our financial rulers decided that British industry was to expand abroad as opposed to letting our own people get the benefit of the new discoveries, and as expansion abroad meant large dealings in foreign currencies, a plan was devised to keep the quotations on these currencies as stable as possible.

This plan has become known as the Gold Standard.

In 1844 the Bank of England bound itself to buy and sell gold in unlimited quantities at fixed prices in £s, consequently anyone bringing gold into this country knew before-hand how many £s he would get and anyone wishing to go abroad knew exactly how much gold he could buy for his £s. If other countries could be persuaded similarly to fix prices anyone wishing to exchange, say £s for francs, had only to buy gold with his £s, ship it to France and sell it for francs. As the prices were fixed in both countries he knew exactly how many francs he would get for a £ and could make plans accordingly.

To cut a long story short most nations were persuaded to follow Britain's example in fixing the price of gold and for a quarter of a century or so, the system worked in a fashion. Nevertheless, its inherent weaknesses will be fairly clear, in that the supply of gold is always limited, and therefore, the amount of

international trade is limited in a most arbitrary manner.

This limitation of the amount of metal led to the building up of a complicated Gold Standard game, whose object was to try and prevent much gold being actually exported. This was done by making it most profitable to put money into the country which had least gold. According to the "game," the supply of money must be restricted in a country which was losing gold, and consequently interest rates rose and prices fell so that it was advantageous to invest money in that country and to take advantage of the low prices to buy goods. This caused a transfer of foreign money to the country concerned, and so a re-importation of gold and the balance was adjusted.

Unfortunately, the preliminary restriction in the money supply prevented industry expanding, prices frequently fell below the cost of production, and unemployment and destitution set in. Rather a high price to pay for stability of foreign exchanges and it is not surprising that the system has now almost universally broken down.

We must now consider the matter in the absence of a Gold Standard. The problem is to discover what is the real value of any of the numerous monetary units. This value must essentially depend upon what the currencies will buy in the country of origin, yet so confused is the public mind on the matter of foreign exchanges, and generally it is so easy to exchange one currency into another, that it is not realised that no currency has any real value outside its own country.

No tradesman or manufacturer in this country

can accept francs or dollars in final settlement of his costs of manufacture, as these costs have been incurred in £s, and it is £s that the manufacturer owes to his bank or to his own company. He may, for the convenience of his customers, temporarily accept foreign currency in exchange for his goods, but he can only do this if he is reasonably certain of being able to re-sell these foreign tokens for £s and to do this he must employ a dealer in foreign exchanges. A foreign exchange dealer is really an organisation for repatriating these monetary units, and if the dealer buys francs or dollars from anyone it is only with a view to re-selling them to someone else who is going to spend them in the country where they were made.

Now this raises a curious question as to why there is all the propaganda about its being unpatriotic to spend one's money abroad. Apparently it is impossible to do so, as if one's capital or income is in £s these must be sold before or immediately after leaving this country, and whoever buys them is only doing so with a view to their being spent over here. It is, as I have explained, impossible to spend £s abroad.

The only significance I can attach to this propaganda is that recently almost all foreign exchange business has been taken over by the banks. I have shown elsewhere that these institutions frequently consider it in their interests to take £s and destroy them. Is it conceivable that when banks take your £s and give you francs they destroy the £s and create new francs to the disadvantage of this country and the benefit of France? I am afraid it is so. When banks

sell property money is destroyed and francs are just as much property as anything else.

Now all this, as previously stated, is beside the point of the introduction of new book-keeping methods in this country. Although complicated in innumerable ways by tariffs, export bounties, equalisation funds, etc., fundamentally the value of any currency is what it will buy in the country of origin and this is a reflection of the price level in that country. The essential feature of the Douglas plan is a reduction of prices to consumers and it should, therefore, cause a rise in the international value of the currency of the country which first adopts these reforms.

While not altogether advantageous, this is exactly the opposite movement to that expressed by those who talk of the £ following the path taken by the German mark in 1923. The essential feature of the fall in the mark was a terrific rise in internal prices. This has led to the error that the internal purchasing power of any currency depends upon its quotation in foreign currencies. Whereas, in fact, the opposite is more nearly the true case.

I have tried then, to clear up some of the confusion of thought which exists on the matter of foreign exchange, but as originally stated, it is by no means of such importance as is popularly believed.



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